

FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 MARCH 2020

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Highways England Company Limited ("Highways England" or "the company") is a private company limited by shares, domiciled in the United Kingdom and registered in England and Wales under the Companies Act 2006.

The company is wholly owned by the Secretary of State for Transport.

The company registration number is 09346363.

The registered office of the company is Bridge House, 1 Walnut Tree Close, Guildford, Surrey GU1 4LZ.

The company's principal activities are to operate, maintain and modernise the Strategic Road Network (SRN) in the interests of its customers. Highways England was incorporated on 8 December 2014 and commenced trading on 1 April 2015, following the transfer of assets and liabilities from the Highways Agency.

INDEPENDENT AUDITOR'S REPORT

INDEPENDENT AUDITOR'S REPORT TO THE SOLE SHAREHOLDER OF HIGHWAYS ENGLAND COMPANY LTD

Opinion on financial statements

I have audited the financial statements of Highways England Company Ltd (the Company) for the year ended 31 March 2020 which comprise the Statements of Comprehensive Net Expenditure, Financial Position, Cash Flows and Changes in Taxpayers' Equity and the related notes, including the significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006. I have also audited the information in the Remuneration Report that is described as having been audited.

In my opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 March 2020 and of its net expenditure for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union; and
- have been prepared in accordance with the Companies Act 2006.

Opinion on regularity

In my opinion, in all material respects the expenditure and income recorded in the financial statements have been applied to the purposes intended by Parliament and the financial transactions recorded in the financial statements conform to the authorities which govern them.

Conclusions relating to principal risks, going concern and viability statement

I have nothing to report in respect of the following information in the annual report, in relation to which the ISAs (UK) require us to report to you whether I have anything material to add or draw attention to:

- the disclosures in the annual report that describe the principal risks and explain how they are being managed or mitigated;
- the directors' confirmation in the annual report that they have carried out a robust assessment of the principal risks facing the Company, including those that would threaten its business model, future performance, solvency or liquidity;
- the directors' statement in the financial statements about whether the directors considered it appropriate to adopt the going concern basis of accounting in preparing the financial statements and the directors' identification of any material uncertainties to the Company's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements; or
- the directors' explanation in the annual report as to how they have assessed the prospects of the group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

Basis of opinions

I conducted my audit in accordance with International Standards on Auditing (ISAs) (UK) and Practice Note 10 'Audit of Financial Statements of Public Sector Entities in the United Kingdom'. My responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of my report. Those standards require me and my staff to comply with the Financial Reporting Council's Revised Ethical Standard 2016. I am independent of the Company in accordance with the ethical requirements that are relevant to my audit and the financial statements in the UK. My staff and I have fulfilled our other ethical responsibilities in accordance with these requirements. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

The regularity framework described in the table below has been applied:

Regularity Framework	
Authorising legislation	<ul style="list-style-type: none">• Infrastructure Act 2015• The Delegation of Functions (Strategic Highways Companies) (England) Regulations 2015• The Licence issued by the Secretary of State for Transport providing statutory directions to the Company
HM Treasury and related authorities	<ul style="list-style-type: none">• The Framework Document between the Department for Transport and the Company• HM Treasury guidance, including <i>Managing Public Money</i>, and Cabinet Office Spending Controls, to the extent they are made applicable to the Company by the Framework Document
Authorities for a company	<ul style="list-style-type: none">• Companies Act 2006• Articles of Association

Overview of my audit approach

Key audit matters

Key audit matters are those matters that, in my professional judgment, were of most significance in my audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that I identified.

I consider the following areas of particular audit focus to be those areas that had the greatest effect on my overall audit strategy, the allocation of resources in my audit and directing the efforts of the audit team in the current year. These matters were addressed in the context of my audit of the financial statements as a whole, and in forming my opinion thereon, and I do not provide a separate opinion on these matters.

This is not a complete list of all risks identified by my audit but only those areas that had the greatest effect on my overall audit strategy, allocation of resources and direction of effort. I have not, for example, included information relating to the work I have performed around the presumed risk of management override of controls under International Standards on Auditing (UK) 240, the Auditor's Responsibility Relating to Fraud in an Audit of Financial Statements, an area where my work has not identified any matters to report.

The areas of focus were discussed with the Audit and Risk Committee; their report on matters that they considered to be significant to the financial statements is set out on page 147.

Comparison to key audit matters communicated in prior year

In this year's report the following changes to the risks identified have been made compared to my prior year report. For each new or continuing audit matter, further detail is available below.

Additional audit effort on continuing areas reflected in this year's key audit matters

My work on the valuation of the Strategic Road Network (SRN) was more extensive this year because of the revaluation of the costing rates for the biggest asset categories for the network. I also improved the coverage of management's estimate for the condition of the network's structures.

As a result of the company's advancing progress with high value road schemes involving property acquisition, I expanded procedures in respect of the related balances, including provisions for statutory blight and compulsory purchase.

My team also expended significant effort in auditing the valuation of the company's accruals. I assessed the inherent risk of misstatement as broadly similar to 2018–19, noting that significant valuation complexity exists in only a minority of accruals. However, I was acutely conscious as my team conducted sample testing of the need to ensure capital accruals reflected actual delivery positions at the Balance Sheet date, given the introduction during March of significant restrictions related to the COVID-19 pandemic. My team also carried out additional testing on the smaller non-capital accruals population in response to errors identified during testing.

New matters driven by material accounting policy changes

Highways England adopted IFRS 16 – Leases for the first time in 2019–20. My team performed focused work in this area, particularly around the valuation of lease liabilities at the point of transition.

Matters on which risk has reduced compared to 2018–19

I continued this year to focus significant audit effort on Highways England’s PFI accounting. Having reviewed in detail in 2018–19 the measurement of the three largest PFI schemes, including for the M25 scheme the impact of an in-year refinancing, my focus this year narrowed to a detailed periodic review of the remaining schemes.

I previously reported on the key audit matters of the Oracle Fusion Implementation and Potential VAT liabilities. This year I found that there were limited changes made to Oracle Fusion during the year, and the VAT liabilities had been settled with HMRC. I have therefore not highlighted a key audit matter in these areas.

1. Valuation of the Strategic Road Network (SRN)	
Description of risk	<p>Revaluation of costing rates – land and road categories</p> <p>The SRN is the dominant component of the accounts (£123.2 billion as at 31 March 2020 inclusive of the technology asset category, which is not included within the scope of the significant risk I raised with the audit committee). The valuation comprises an estimate of the depreciated replacement cost of the SRN, as a proxy for its fair value in the absence of income- or market-based sources. The estimate uses the best information available on the actual cost of recent schemes, together with records about the number, type and condition of physical assets.</p> <p>A number of assumptions are implicit in determining the SRN valuation, the validity of which needs keeping under review; for example, whether costing rates for material SRN elements remain a reasonable basis for valuing a modern equivalent asset. In 2019–20, management carried out a full revaluation for the land and road asset categories. These rates are constructed by analysing previous scheme costs and making adjustments in line with generally accepted depreciated replacement cost principles, such as the use of a greenfield basis. Management also consider other evidence on cost estimation as they apply the new rates.</p> <p>In addition to the core rates, management also used recent scheme outturns to recalculated uplifts including:</p> <ul style="list-style-type: none">land compensation costs, reflecting the additional costs of compulsory acquisition;preparation and supervision rates which are applied to all asset categories to reflect greenfield-relevant costs outside of direct labour & materials; andan uplift for Smart Motorways, reflecting the additional replacement cost for these assets compared to the baseline measurement. <p>Management also chose to use a different index to uplift costs, HECl, which is specific to Highways England’s programme of work. This was relevant for this year’s exercise, since in order to maximise the reliability of the valuation procedures, management chose to baseline the full revaluation of costing rates as at 31 March 2019, and to use indexation to adjust these to current cost as at the Balance Sheet date.</p> <p>Condition assessment – road and structure categories</p> <p>Management adjust the valuation of the network based on the observed condition of its assets. This measurement is most sensitive to change in respect of the road asset category – into which management have added additional condition indicators during this year – and structures, where management use a cost-weighted analysis of physical inspection data to estimate the useful life remaining for its portfolio of road structures.</p> <p>Further detail on judgements and estimates</p> <p>The SRN valuation contains multiple areas of judgement and estimation uncertainty. I treat this area as a significant matter for audit because of the inherent complexity and estimation uncertainty. The Company details the critical judgements and estimates they have made in relation to the SRN at note 6.2 and note 9 in the financial statements.</p>

1. Valuation of the Strategic Road Network (SRN) (continued)	
How the scope of my audit responded to the risk	<p>My procedures on the SRN valuation are geared towards evaluating the reasonableness of management’s estimate of its value, to assess:</p> <ul style="list-style-type: none">the quality of source data in the underlying databases;the reasonableness of revised costing rates (land, road) and cost indexation factors applied in-year;and the adjustments made in respect of the network’s condition based on the available evidence from asset management activities, amongst other key assumptions. <p>I also considered whether any of my findings were indicative of management bias.</p> <p>Revaluation of costing rates – land and road</p> <p>My team evaluated management’s revaluation of its land holdings with reference to a reputable independent set of rates.</p> <p>The greatest part of my audit effort was directed towards the more complex revaluation of road costing rates. On this, I:</p> <ul style="list-style-type: none">reperformed management’s calculation of the costing rates from underlying data;engaged an auditor’s expert to review the appropriateness of the costing rates and the main uplifts applied;assessed the reasonableness of management’s statistical analysis which transforms historically derived rates for the most common road types to the full set of road types;with the assistance of the auditor’s expert, evaluated the appropriateness of ‘modern equivalent’ costing rates in the context of actual network characteristics, principally in valuing the technical valuation adjustment in respect of central reservation barriers; andevaluated the application of the calculated costing rates in the valuation model. <p>Condition assessment – road and structures categories</p> <p>I assessed the reasonableness of the use of new condition indicators in the valuation of the road network, as well as addressing the reliability of key source data.</p> <p>In respect of structures, with the assistance of a civil engineering focused auditor’s expert, I:</p> <ul style="list-style-type: none">confirmed the reasonableness of management’s cost-weighted condition methodology;evaluated the reasonableness of management’s analysis of its inspection data; andconsidered the reliability and relevance of that data. <p>Key observations</p> <p>During the year, the net SRN valuation increased by £4.6 billion. The main driver of this increase was the full revaluation of the road asset, as the costing rates increased across all road types, and both the preparation and supervision and land compensation uplifts increased, and these are applied to all asset categories.</p> <p>In the course of completing this work, I worked with management to identify a number of adjustments to ensure that the costing rates properly reflected the overall network, including adjusting for the specific features of schemes used to construct costing rates, and where the modern equivalent differed from the actual network. Following adjustments, I did not identify any material misstatements in the valuation of the road network recognised and disclosed in the financial statements.</p>
2. Implementation of IFRS 16 Leases	
Description of risk	<p>Highways England implemented the new IFRS 16 Leases accounting standard on 1 April 2019. The new standard requires lessees to recognise nearly all leases on the Statement of Financial Position, both as an asset representing their right to use an asset for a period of time, and a liability representing its obligation to make the associated lease payments. The company recognised £60 million of right of use assets and £64 million of lease liabilities on transition.</p> <p>The implementation is data-intensive, with the company having to collate data from around the business and make judgements, for example on the appropriate incremental borrowing rate and whether they are reasonably certain that break or extension clauses will be enacted to determine the lease term.</p> <p>Although the balance of assets and liabilities recognised on transition is immaterial, I identified this area as a significant area of focus given the significant change brought about by this accounting standard.</p>
How the scope of my audit responded to the risk	<p>I reviewed the processes and controls implemented to capture and assess arrangements that could contain a lease or an embedded lease. This included a review by the Company, which my team reperformed, of significant construction contracts.</p> <p>I reviewed the lease register used against listings previously provided for audit, as the company applied the practical expedient as allowed by IFRS 16 to transition only leases previously identified as such under IAS 17.</p> <p>I performed a sample test of historical leases and tested all new leases in-year, and reviewed management’s judgements around lease terms. I also reviewed the appropriateness of the incremental borrowing rate used which is theoretically based since the Company is funded entirely by contributions from its controlling party.</p> <p>Key observations</p> <p>Having evaluated my team’s work on the implementation of IFRS 16, I did not identify any material misstatements in the completeness or valuation of the lease assets and liabilities recognised and disclosed in the financial statements.</p>

3. Accounting for Land and Property Purchases	
Description of risk	<p>The company recognised provisions of £237.6m at 31 March 2020 for land and property acquisition. These relate to the estimated cost of planning blight, discretionary and compulsory acquisition of property and compensation for property owners arising from physical construction of road schemes.</p> <p>Given that the provisions balance is increasing as the company progresses significant projects such as the Lower Thames Crossing, I considered there to be an increasingly relevant element of judgement and uncertainty within this balance.</p> <p>Further information on the accounting for land and property purchases is included in notes 7.4 and 9.3 of the financial statements.</p>
How the scope of my audit responded to the risk	<p>I performed the following procedures over the accounting for land and property purchases:</p> <ul style="list-style-type: none">engaged an auditor's expert to review the company's own expert's work against the Compensation Code;reviewed the accounting treatment of provisions and contingent liabilities against IAS 37 and challenged the company on the appropriateness of its accounting for blight; andtested a sample of provisions at year end to agree the valuation and existence to supporting information. <p>Key observations</p> <p>My work concluded that the company's accounting policy is within the range permitted by IAS 37. In the course of completing this work, I did not identify any material misstatements in the provisions balance recognised and disclosed in the financial statements.</p>
4. Private Finance Initiative (PFI) contracts	
Description of risk	<p>Following recognition in previous years, the company has on Balance Sheet £1.4 billion of PFI liabilities as at 31 March 2020. I reviewed the three largest – M25, A1(M1) and A1 Darrington to Dishforth – in detail last year. During the year, the company reviewed their accounting model for the remainder for any anomalies, and against the financial close models which describe the basis on which unitary payment streams were originally set. A number of these contracts are nearly 25 years old and the company was required to make judgements using the best information available.</p> <p>Further information on PFI contracts is included in note 7.5.2 in the financial statements.</p>
How the scope of my audit responded to the risk	<p>In respect of PFI contracts on which I had not performed a detailed periodic review in the prior year, I:</p> <ul style="list-style-type: none">reviewed the financial close models, and using information from these, calculated an auditor's range for the plausible closing balance obligations at 31 March 2019 and 31 March 2020 for each contract (the key variable being the extent of apportionment of the contractor's profit element to capital elements of the contract); andreviewed the disclosures made in the financial statements against each model and supporting information. <p>Key observations</p> <p>I identified for some contracts that the end dates per the company's accounting models were not consistent with the financial close model, or the company's own forecasted payment schedule. The company made an adjustment for £66 million to correct this, as disclosed in note 7.5.2.</p> <p>When corrected for the above issue, I concluded that the closing balance of £1.4 billion was within the auditor's range.</p> <p>I also confirmed that there was no material prior year error as a result of the incorrect end dates.</p>

5. Accruals	
Description of risk	<p>Where work has been performed by the company or its contractors by the year end, but an invoice has not been raised, the company raises an accrual for the expected costs. The largest balances relate to for accruals relating to its capital investment in the road network, for example on renewals and enhancement projects.</p> <p>The company expects to be well informed about these costs, but there remains a level of estimation at the year end about the amount of work delivered. This may differ from plan, for example as a result of unexpected under or over-delivery by Highways England's contractors. Both controllable factors (e.g. contractor project management) and uncontrollable factors (e.g. ground conditions and weather) provide a level of estimation uncertainty which the company addresses through a post Balance Sheet review exercise. These factors are part of the estimation uncertainty outlined by the company under the comments concerning cost of work done in the 'Critical accounting judgements and key sources of uncertainty' section in Note 9.2.</p>
How the scope of my audit responded to the risk	<p>I substantively tested the accruals balance using a stratified sample testing approach, which allowed me to focus on higher value accruals and split resource and capital accruals. This testing identified that the company does not always update the valuation of their accruals for information that comes to light after the balance sheet date. It also identified a higher level of estimation uncertainty in projects that are nearly completed, where the company and its contractors are negotiating the final settlement.</p> <p>I performed additional testing of resource accruals as a result of a higher than expected level of error.</p> <p>Management made a £8 million adjustment to its accruals balance as a result of an identified overstatement of work performed in the year.</p> <p>Key observations</p> <p>By extrapolating the additional testing over the full accruals population, I was able to gain sufficient assurance the accruals balance was not materially misstated.</p>

Application of materiality

I applied the concept of materiality in both planning and performing my audit, and in evaluating the effect of misstatements on my audit and on the financial statements. This approach recognises that financial statements are rarely absolutely correct, and that an audit is designed to provide reasonable, rather than absolute, assurance that the financial statements are free from material misstatement or irregularity. A matter is material if its omission or misstatement would, in the judgement of the auditor, reasonably influence the decisions of users of the financial statements.

Based on my professional judgement, I determined overall materiality for the Company's financial statements at £1.2 billion, which is approximately 1% of the value of the SRN asset. I chose this benchmark given users' interest in the Company's performance in managing and enhancing the SRN. I have determined that for non-SRN transactions and balances, and for SRN capital additions, misstatements of a lesser amount than overall materiality could influence the decisions of users of the accounts, given additional user interest in the publicly funded cost of the Company's activities. I have therefore determined that the level to be applied to these components is £67 million, being approximately 1.5% of the Company's total expenditure, excluding non-cash costs such as depreciation and impairment, but including capital additions.

As well as quantitative materiality there are certain matters that, by their very nature, would if not corrected influence the decisions of users, for example, any errors reported in Directors' Remuneration Report. Assessment of such matters would need to have regard to the nature of the misstatement and the applicable legal and reporting framework, as well as the size of the misstatement.

I applied the same concept of materiality to my audit of regularity. In planning and performing audit work in support of my opinion on regularity and evaluating the impact of any irregular transactions, I took into account both quantitative and qualitative aspects that I consider would reasonably influence the decisions of users of the financial statements.

I agreed with the Audit and Risk Committee that I would report to it all uncorrected misstatements identified through my audit in excess of £300,000, as well as differences below this threshold that in my view warranted reporting on qualitative grounds.

Total unadjusted audit differences reported to the Audit Committee in respect of the SRN, against overall materiality, would have decreased net assets by £630 million. Total unadjusted audit differences reported to the Audit Committee relevant to the additional materiality (i.e. in respect of non-SRN transactions and balances and capital additions) would have increased net assets by £17 million.

Responsibilities of the Directors for the financial statements

As explained more fully in the Directors' Responsibilities Statement, the directors are responsible for:

- the preparation of the financial statements and for being satisfied that they give a true and fair view;
- such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.
- assessing the Company's ability to continue as a going concern, disclosing, if applicable, matters relating to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the group or the parent company or to cease operations, or have no realistic alternative but to do so.

Auditor’s responsibilities for the audit of the financial statements

My responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (ISAs) (UK).

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. Reasonable assurance is a high level of assurance but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs (UK), I exercise professional judgment and maintain professional scepticism throughout the audit. I also:

- identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control.
- evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

I communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.

I also provide those charged with governance with a statement that I have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on my independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, I determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. I describe these matters in my auditor’s report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, I determine that a matter should not be communicated in my report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

In addition, I am required to obtain evidence sufficient to give reasonable assurance that the income and expenditure reported in the financial statements have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

Audit scope

The scope of my audit was determined by obtaining an understanding of the entity and its environment, including entity-wide controls, and assessing the risks of material misstatement at the Group level.

Other Information

Directors are responsible for the other information. The other information comprises information included in the annual report but does not include the parts of the Remuneration Report described in that report as having been audited, the financial statements and my auditor’s report thereon. My opinion on the financial statements does not cover the other information and I do not express any form of assurance conclusion thereon. In connection with my audit of the financial statements, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or my knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work I have performed, I conclude that there is a material misstatement of this other information, I am required to report that fact. I have nothing to report in this regard.

I am specifically required to address the following items and to report uncorrected material misstatements in the other information, where I conclude that those items meet the following conditions:

- Fair, balanced and understandable: the statement given by the directors that the annual report and accounts taken as a whole are fair, balanced and understandable and provide the necessary information to enable users to assess the entity’s performance, business model and strategy, is materially inconsistent with my knowledge obtained in the audit; or
- Audit Committee reporting: the section describing the work of the Company’s Audit and Risk Committee does not appropriately address matters communicated by me to the Audit and Risk Committee.

I also have nothing to report in this regard.

Opinion on other matters prescribed by the Companies Act

Directors’ remuneration

In my opinion the part of the Directors’ Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006.

I also report to you if, in my opinion, certain disclosures of directors’ remuneration required have not been made. I have nothing to report arising from this duty.

The strategic and directors’ reports

In my opinion, based on the work undertaken in the course of the audit, the information given in the Strategic and Directors’ Report for the financial year for which the financial statements are prepared is consistent with the financial statements and those reports have been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the group and the company and its environment obtained in the course of the audit, I have not identified any material misstatements in the Strategic Report or the Directors’ Report.

The corporate governance statement

In my opinion, based on the work undertaken in the course of the audit:

- the information given in the corporate governance report, in compliance with rules 7.2.5 and 7.2.6 in the Disclosure Rules and Transparency Rules sourcebook made by Financial Conduct Authority (the FCA Rules), in respect of internal control and risk management systems in relation to financial reporting processes, and about share capital structures, is consistent with the accounts and has been prepared in accordance with applicable legal requirements.
- rules 7.2.2, 7.2.3 and 7.2.7 of the FCA Rules about the Company’s corporate governance code and practices and about its administrative, management and supervisory bodies and their committees have been complied with.

Based on my knowledge and understanding of the Company and its environment obtained during the course of the audit, I have identified no material misstatements in this information.

Matters on which I report by exception

Adequacy of accounting records information and explanations received

I report to you if, in my opinion:

- adequate accounting records have not been kept, or returns adequate for my audit have not been received from branches not visited by my staff;
- the financial statements and the part of the Remuneration report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of directors’ remuneration specified by law are not made;
- I have not received all of the information and explanations I require for my audit; or
- a corporate governance statement has not been prepared by the parent company.

I have nothing to report arising from this duty.

Matthew Kay
Senior Statutory Auditor



For and on behalf of the
Comptroller and Auditor General (Statutory Auditor)
National Audit Office
157-197 Buckingham Palace Road
London, SW1W 9SP

04 September 2020

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Statement of comprehensive net expenditure for the year ended 31 March 2020

	Note	Year to 31 March 2020 £000	Year to 31 March 2019 £000
Staff costs	3	157,512	150,233
Maintenance and similar activities		508,016	509,246
Interest on PFI finance leases	7.5.2	134,739	109,001
PFI service charges	7.5.3	348,405	276,965
Depreciation and amortisation	6.1 & 6.4	1,171,597	1,212,044
Impairment	6.1 & 6.5	29,890	840
Loss on sale of assets including detrunking	6.2	29,507	54,017
Other expenditure	4	148,325	146,114
Operating income	2	(59,676)	(68,735)
Net expenditure before taxation		2,468,315	2,389,725
Taxation	5	(75)	2
Net expenditure after taxation		2,468,240	2,389,727
Other comprehensive net expenditure			
Items that will not be reclassified to net expenditure			
Net gain on remeasurement of property, plant and equipment	6.2	(3,445,304)	(3,843,034)
Total comprehensive income for the year		(977,064)	(1,453,307)

The accounting policies and notes on pages 175 to 213 form part of these accounts.

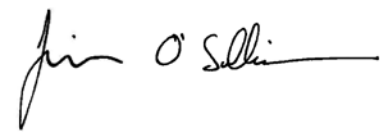
Statement of financial position as at 31 March 2020

	Note	31 March 2020 £000	31 March 2019 £000
Non-current assets:			
Property, plant & equipment	6.1	126,158,252	120,631,557
Intangible assets	6.4	14,998	20,011
Trade and other receivables	7.2	10,569	11,854
Total non-current assets		126,183,819	120,663,422
Current assets:			
Assets classified as held for sale	6.5	11,962	16,270
Inventories	6.6	49,205	46,991
Trade and other receivables	7.2	272,418	172,972
Cash and cash equivalents	7.1	762	16,395
Total current assets		334,347	252,628
Total assets		126,518,166	120,916,050
Current liabilities:			
Trade and other payables	7.3	913,071	773,841
Provisions	7.4	163,874	198,291
Total current liabilities		1,076,945	972,132
Non-current assets less net current liabilities		125,441,221	119,943,918
Non-current liabilities:			
Provisions	7.4	125,712	143,667
Other payables	7.3	1,426,437	1,404,243
Total non-current liabilities		1,552,149	1,547,910
Assets less liabilities		123,889,072	118,396,008
Taxpayers' equity:			
Share capital		–	–
Capital contributions		49,873,712	49,656,937
Retained earnings		6,157,944	4,110,184
Revaluation reserve		67,857,416	64,628,887
Total taxpayers' equity		123,889,072	118,396,008

The accounting policies and notes on pages 175 to 213 form part of these accounts.

The issued share capital of the company is £10, as detailed in note 8.

These financial statements were approved and authorised for issue by the Board of Directors on 29 July 2020, and were signed on its behalf by:



Jim O’Sullivan, Chief Executive Officer
Company registered number: 9346363

Statement of cash flows for the year ended 31 March 2020

	Note	Year to 31 March 2020 £000	Year to 31 March 2019 £000
Cash flows from operating activities			
Net operating cost		(2,468,240)	(2,389,727)
Adjustments for non-cash transactions:			
Depreciation and amortisation	6.1 & 6.4	1,171,597	1,212,044
Loss on sale of fixed assets		29,507	54,017
Net increase in resource provisions	7.4	26,789	45,443
Programme impairments		29,890	840
Interest on leases	7.5.1	1,392	–
Reduction in IFRS 16 assets for rent free periods elapsed		4,380	–
Increase in inventories	6.6	(2,214)	(10,068)
(Increase)/decrease in trade and other receivables	7.2	(98,161)	51,682
Increase/(decrease) in trade and other payables	7.3	161,424	(114,904)
<i>Less movement in payables relating to items not passing through the SoCNE</i>	7.5.1	(64,529)	–
Use of capital provisions	7.4	(134,283)	(51,747)
Use of resource provisions	7.4	(70,166)	(2,560)
Adjustment for capital element of PFI payments	7.5.2	16,389	77,763
Net cash outflow from operating activities		(1,396,225)	(1,127,217)
Cash flows from investing activities			
Purchase of property, plant and equipment	6.1	(3,256,354)	(2,807,769)
Non-cash movement on creation of IFRS 16 asset	6.1	13,376	–
Proceeds on disposal of assets		13,058	7,763
Capital element of movement in provisions	7.4	124,504	184,659
Net cash outflow from investing activities		(3,105,416)	(2,615,347)
Cash flows from financing activities			
Capital contribution from Shareholder: current year		4,516,000	3,818,000
Capital element of payments in respect of on balance sheet PFI contracts	7.5.2	(16,389)	(77,763)
Payment of lease liabilities	7.5.1	(13,603)	–
Net financing		4,486,008	3,740,237
Net decrease in cash and cash equivalents in the year		(15,633)	(2,327)
Cash and cash equivalents at the beginning of the year	7.1	16,395	18,722
Cash and cash equivalents at the end of the year	7.1	762	16,395

Statement of changes in taxpayers’ equity for the year ended 31 March 2020

Note	Capital contributions £000	Retained earnings £000	Revaluation reserve £000	Total equity £000
Balance at 1 April 2018	49,538,620	2,681,911	60,904,170	113,124,701
Changes in taxpayers’ equity for 2018–19				
Net (loss)/gain on remeasurement of property, plant and equipment	(101,854)	–	3,944,888	3,843,034
Transfers between reserves	220,171	–	(220,171)	–
Net comprehensive expenditure after taxation for the year	–	(2,389,727)	–	(2,389,727)
Total recognised income and expenditure for the year ended 31 March 2019	49,656,937	292,184	64,628,887	114,578,008
Funding from Shareholder	–	3,818,000	–	3,818,000
Balance at 31 March 2019	49,656,937	4,110,184	64,628,887	118,396,008
Balance at 1 April 2019	49,656,937	4,110,184	64,628,887	118,396,008
Changes in taxpayers’ equity for 2019–20				
Net (loss)/gain on remeasurement of property, plant and equipment6.2.iii.b	(29,162)	–	3,474,466	3,445,304
Transfers between reserves	245,937	–	(245,937)	–
Net comprehensive expenditure after taxation for the year	–	(2,468,240)	–	(2,468,240)
Total recognised income and expenditure for the year ended 31 March 2020	49,873,712	1,641,944	67,857,416	119,373,072
Funding from Shareholder	–	4,516,000	–	4,516,000
Balance at 31 March 2020	49,873,712	6,157,944	67,857,416	123,889,072

NOTES TO THE FINANCIAL STATEMENTS

1 Significant changes in the current period

The financial position and performance of the company was particularly affected by the following events and transactions during the reporting period:

- Pavement and lands quinquennial revaluation (QQR) which created a £6.5 billion increase in value driven by increases in construction costs (£9.9 billion) offset by a ‘technical adjustment’ (£3.4 billion) (note 6.2.iii.b).
- The adoption of the new accounting standards for Leases – International Financial Reporting Standards IFRS 16 (see note 19). This increased Right of Use (ROU) assets by £63.7 million (note 6.1) and lease liabilities by £64.5 million (note 7.5.1).

For a review of the company’s performance and financial position please see the financial summary on pages 12 to 16.

To understand how our funding ties into our financial accounts see note 22 for the FReM¹ disclosures.

HOW THE NUMBERS ARE CALCULATED

2 Operating income

Operating income relates directly to the operating activities of the company and arises from:

- **Recoveries from third parties** for damage to the Strategic Road Network (SRN)
- **Third party contributions** to road schemes
- **Fees and charges** for work carried out on a full-cost basis to external customers in both the public and private sectors
- **Other income** relating to income from short term lettings, income from vehicle recoveries on the network, grant income and Memorandum of Understanding (MOU) income received from government departments for the use of office space

	Year to 31 March 2020 £000	Year to 31 March 2019 £000
Operating income analysed by classification and activity is as follows:		
Recoveries from third parties for damage to the SRN	(6,866)	(9,002)
Contribution to road schemes	(25,827)	(26,835)
Fees and charges to external customers	(10,158)	(17,698)
Other income	(16,825)	(15,200)
Total operating income	(59,676)	(68,735)

The revenue recognition principles for each of the major revenue streams are outlined below and while the company does not have customers in the traditional sense, it has applied the principles of IFRS 15 (revenue recognition) where relevant as a matter of good practice.

- **Recovery from third parties for damage to the SRN.** The company considers that past events involving damage to the network initially create a contingent asset under IAS 37 (provisions, contingent liabilities and contingent assets), since they create a situation whereby a reimbursement by the offending party is probable. Income (and a receivable) is recognised at the point at which an insurance company decides that they will make a payment, as it is then considered that reimbursement is virtually certain.
- **Contribution to road schemes** relates to contributions to projects from third parties. Contributions are received from developers or local authorities who require us to tailor our schemes in line with the needs of their own development projects. Revenue fluctuates dependent upon the number and size of developments taking place alongside our programme and is apportioned based upon the percentage of construction completed. This aligns with the requirements of International Accounting Standard IAS 20 (Grants from government) which requires income to be systematically recognised over a period to match it with related cost.
- **Fees and charges to external customers** relate to contributions to schemes from third parties under S274/278 contracts. Revenue in relation to this type of contract is received in advance and is then held as deferred income until costs are incurred to fulfil the contract. The treatment of this revenue is consistent with IFRS 15 section 35(b), whereby revenue is recognised over time as the asset is created or enhanced.

The reduction in income on fees and charges year on year relates to a reduction in work on a number of section 274/278² projects including the M25 HS2 Slip roads project, where spend has reduced to £1.9 million in the year (2018–19 £10.8 million).

- **Other income** relates to various less material revenue streams including income relating to vehicle recovery, short-term property lettings, grant income and income from MOU agreements with government departments.

Operating income is stated net of recoverable VAT and is measured at the fair value of the consideration received or receivable.

Further information and disclosure under FReM can be found in the FReM Disclosures, note 22 on page 207.

1 FReM refers to the government financial reporting manual. This is the technical accounting guide for the preparation of government financial statements.
2 S274/278 schemes occur where a third party requests to fund changes to the strategic road network, usually to improve connections for other local authorities or developer led projects.

3 Staff numbers and related costs

3.1 Staff costs

	Year to 31 March 2020			Year to 31 March 2019
	Permanent staff £000	Other £000	Total £000	Total £000
Wages and salaries	230,646	3,083	233,729	217,843
Social security costs	25,928	–	25,928	23,285
Other pension costs	36,185	–	36,185	30,107
Total gross costs	292,759	3,083	295,842	271,235
Capitalised staff costs	(136,852)	(1,456)	(138,308)	(120,983)
Less recoveries in respect of outward secondments	(22)	–	(22)	(19)
Total net costs	155,885	1,627	157,512	150,233

Permanent staff are those staff with a permanent employment contract with the company. Other relates to contingent labour.

Wages and salaries includes gross salaries, performance pay or bonuses, overtime, recruitment and retention allowances, ex-gratia payments and any other taxable allowances or payments, as well as costs relating to agency, temporary and contract staff engaged by the company on a contract to undertake a project or task.

Salaries, wages and employment-related payments are recognised in the period in which the service is received from employees.

Performance-related bonuses

At the year end, each employee's performance has not been formally assessed and consequently the pay increases and bonus payments for the year to 31 March are not yet known. However, the work has been completed and therefore a liability is created. The value of the bonuses to be paid is estimated and accrued based on all information that is available including: company performance forecasts, previous employee performances and performance related pay scheme details. This is aligned to accounting standard IAS 19 (employee benefits).

Holiday pay

Employees of the company have different holiday leave year end dates based upon their date of employment. As leave is used during the year at different times compared to a straight line accrual, at 31 March there is an element of leave that is owed either by the company to employees or owed by employees to the company. The cost of leave earned but not taken by employees is recognised in the financial statements.

Termination

Termination benefits are amounts payable as a result of a decision by the company to terminate employment before the normal retirement date, or a decision by an employee to accept voluntary redundancy. Amounts payable are charged on an accruals basis to staff costs in net expenditure when the company is formally committed to ending an employment contract.

Pensions

The company's employees are involved in three main pension schemes: The Principal Civil Service Pension Scheme (PCSPS), the Highways England Personal Pension (Defined Contribution) Scheme (HEPP), and the Federated Pension Plan (FPP), described in more detail below. Due to the nature of the joining criteria, the membership in PCSPS is on the decline, while membership in the HEPP scheme is increasing and membership in FPP is increasing but at a much slower rate.

Employees who transferred to the company from the Highways Agency on 31 March 2015 retained participation in the PCSPS.

The PCSPS is an unfunded multi-employer defined benefit scheme. The company is unable to identify its share of the underlying assets and liabilities of the scheme on a consistent and reasonable basis and therefore, as required by accounting standard (IAS 19 employee benefits), accounts for the scheme as if it were a defined contribution scheme.

Employees who joined the company with effect from 1 April 2015 are eligible to participate in the HEPP. The pension scheme came into effect on 1 April 2015 and is managed on the company's behalf by Legal & General Ltd.

Highways England also has an FPP which is a master-trust defined benefit scheme managed on the company's behalf by Pan Trustees Limited. The FPP was established on 1 July 2016 to accommodate pension benefits protected under TUPE for employees transferring in to Highways England with legacy defined benefit pensions. The FPP currently has a small but growing membership and is used to provide comparable pension benefits for transfers into Highways England, where protected by legislation.

Under the PCSPS and the HEPP, pension liabilities do not rest with the company. For all schemes, employer pension contributions are recognised as they become payable following qualifying service by employees.

a) **The Principal Civil Service Pension Scheme (PCSPS)** is an unfunded multi-employer defined benefit scheme. A full actuarial valuation was carried out as at 31 March 2012. Details regarding the scheme can be found in the resource accounts of the Cabinet Office: Civil Superannuation (www.civilservice.gov.uk/pensions).

For 2019–20, employers' contributions of £24.6 million (2018–19 £20.4 million) were payable to the PCSPS at one of four rates in the range 26.6% to 30.3% (2018–19 20.0% to 24.5%) of pensionable earnings, based on salary bands. The scheme actuary reviews employer contributions usually every four years following a full scheme valuation. The contribution rates are set to meet the cost of the benefits accruing during 2019–20 to be paid when the member retires and not the benefits paid during this year to existing pensioners.

Employees can opt to open a partnership pension account, a stakeholder pension with an employer contribution. Employer's contributions of £0.2 million (2018–19 £0.2 million) were payable to one or more of the panel of five appointed stakeholder pension providers. Employer contributions are age-related and range from 8% to 14.75% (2018–19 8% to 14.75%). The company also matches employee contributions up to 3% of pensionable earnings. In addition, employer's contributions of £4,900 (2018–19 £5,800), 0.5% (2018–19 0.5%) of pensionable pay, were payable to the PCSPS to cover the cost of the future provision of lump sum benefits on death in service or ill health retirement of these employees.

Contributions due to the partnership pension providers as at 31 March 2020 were £11,200 (2018–19 £11,900). Contributions prepaid at that date were £nil (2018–19 £nil).

b) **The Highways England Pension Plan** is a defined contribution Group Personal Pension Plan administered by a third-party provider. Highways England matches employee contributions to personal pension plans on a 2:1 basis, up to a maximum of 10% of gross salary. The default contributions are 5% (employee) and 10% (employer). In addition, life insurance cover is provided for members of the plan at an average cost of 0.55% of gross salary. This meets our statutory obligation to provide a workplace pension under current legislation.

As this is a defined contribution scheme, Highways England incurs no liability for future pension costs of members of the pension plan. For 2019–20, employers' contributions of £10.9 million (2018–19 £8.7 million) were payable to the plan.

c) **The Federated Pension Plan – Highways England section (FPP)** is a master-trust defined benefit pension plan, administered by PAN Trustees. Employer contributions are set between 41.0% and 41.5% of pensionable earnings (dependent upon contractual employee contribution rates at the time of transfer). Employer's contributions of £0.5 million were paid to the FPP during 2019–20 (2018–19 £0.2 million). The contribution rates were set based on an actuarial valuation of the scheme at inception in July 2016.

d) **Severn River Crossing Pension Plan** – In 2018–19 the company started a transitional arrangement for the staff transferred from Severn River Crossing plc. These staff contributed to an existing private pension scheme whilst arrangements were sought to bring them into one of the existing three plans. The scheme closed during 2019–20. Employer's contributions to the scheme during the year were £0.1 million (2018–19 £0.4 million).

3.2 Average number of persons employed

The average number of full time equivalent persons employed during the year was as follows:

	Year to 31 March 2020			Year to 31 March 2019
	Permanent staff	Other	Total	Total
Traffic officer staff	1,734	–	1,734	1,655
Direct support to front line projects and service delivery	1,803	8	1,811	1,754
Staff engaged on capital projects	2,160	7	2,167	2,020
Average FTE persons employed	5,697	15	5,712	5,429

During the year ending 31 March 2020 the actual full time equivalent employees (FTE) increased from 5,517 to 5,722. The growth has focused on our key capability areas such as programme and project management, asset management and commercial roles.

4 Other expenses

	Note	Year to 31 March 2020 £000	Year to 31 March 2019 £000
Information technology		42,439	37,814
Research and development expenditure		7,449	8,471
Rates and building costs		19,096	12,522
Provisions expenditure	7.4	27,817	46,416
Rent		1,210	6,949
Interest under IFRS 16	7.5.1	1,392	–
Travel and subsistence		6,080	4,884
Traffic management vehicle costs		3,042	7,030
Recruitment and training		5,893	5,862
Consultancy		2,842	2,483
Communication		2,711	3,948
Stationery		734	1,162
Other		27,620	8,573
Total		148,325	146,114

Building maintenance, landlord service charges and business rates have increased by £6.6 million in the year as the property portfolio has expanded. Underlying rental charges have also increased in year by £5 million, however, the introduction of IFRS 16 (Leases) has resulted in £11 million of expenditure being transferred to leased assets and the expense is now realised in additional depreciation and interest.

The year-on-year decrease in provisions is due to a reduction in VAT provisions relating to Hybrid schemes.

Lower traffic manager vehicle costs are as a result of purchases of new fleet vehicles in the prior year, reducing maintenance requirements.

Stock is the biggest movement within ‘Other’, with a £19 million movement as stock balances have been reviewed, rationalised and historical discrepancies have been written-off

Excluding VAT the auditor fee of the Comptroller and Auditor General for the year ending 31 March 2020 is £322,000 (2018–19 £310,000), and is in relation to the audit of the 2019–20 financial statements of Highways England £257,000 (2018–19 £245,000); and Dartford-Thurrock River Crossing Charging Scheme £65,000 (2018–19 £65,000). This amount is included in ‘Other’ above.

Expenditure on research is not capitalised. Development expenditure that does not meet criteria for capitalisation is also treated as an expense and shown in net expenditure in the year in which it is incurred.

5 Corporation Tax

From a Corporation Tax perspective, the company is not trading with a view to a profit and the contributions received from DfT in relation to the company’s principal activity of managing the UK road network are not chargeable to Corporation Tax.

The company is only liable for Corporation Tax in relation to income earned from business activities. Business activities for the company are non-statutory obligations where the company is in competition with other providers. Income from business activities includes sale and rental of properties purchased as part of road schemes.

	Year to 31 March 2020 £000	Year to 31 March 2019 £000
a) Analysis of the tax (credit)/charge		
Current taxation		
UK Corporation Tax	–	–
Adjustments in respect of prior years	(75)	2
	(75)	2
b) Factors affecting the tax (credit)/charge for the year		
The effective rate of tax for the period is less than the standard rate of Corporation Tax in the UK of 19% (2018–19 19%)		
The differences are explained below:		
Net expenditure on ordinary activities	(2,468,315)	(2,389,725)
Net expenditure on ordinary activities multiplied by standard rate of Corporation Tax in the UK of 19% (2018–19 19%)	(468,980)	(454,048)
Effect of:		
Income and expenditure not subject to Corporation Tax	468,980	454,048
	–	–

Tax on the profit or loss for the year comprises current and deferred tax. Tax is recognised in net expenditure except to the extent that it relates to items recognised in equity, in which case it is recognised in equity.

Current tax is the expected tax payable or receivable on the current taxable income or loss for the year, using tax rates enacted at the balance sheet date and any adjustment to tax payable in relation to previous years. The £75,000 tax credit relates to a corporation tax over provision in 2018.

At Summer Budget 2015, the government announced legislation setting the Corporation Tax main rate (for all profits except ring fence profits) at 19% from 1 April 2017 and at 18% from 1 April 2020. At Budget 2016, the government announced a further reduction to the Corporation Tax main rate (for all profits except ring fence profits) for the year starting 1 April 2020, setting the rate at 17%.

The company has no deferred tax as business activity is minimal.

6
Non-financial assets and liabilities

This note provides information about the company's financial assets and liabilities. This covers:

- Property, plant and equipment – (both SRN and non-SRN)
- Intangible assets
- Assets held for sale
- Inventory

Employee benefit obligations are captured within the staff costs in note 3.

Property, plant and equipment is sub-categorised into:

- The SRN – This consists of the motorways and trunk roads in England (as depicted by the network management map), which form a single integrated network and includes assets under construction (AUC).
- Non-network assets – These include land, buildings and information technology outside the SRN's perimeter, as well as all plant and machinery and assets held under leases as defined by IFRS 16.

6.1
Property, plant and equipment
2019–20

	SRN and related AUC £000	Non SRN AUC £000	Land £000	Buildings £000	Dwellings £000	Plant and machinery £000	Information technology £000	Leased assets £000	Total £000
Cost or valuation									
At 1 April 2019	135,231,716	30,176	181,360	228,155	55,018	164,170	5,852	–	135,896,447
Leases recognised under new standard	–	–	–	–	–	–	–	59,769	59,769
Capital additions	3,150,522	92,451	–	–	–	5	–	13,376	3,256,354
Disposals	–	–	(5,397)	–	(1,279)	(17,040)	(597)	–	(24,313)
Revaluation	8,489,624	64,522	7,140	4,944	7,088	1,322	44	–	8,574,684
Valuation adjustments	(657,626)	–	–	–	–	–	–	–	(657,626)
Technical valuation adjustment	(3,427,470)	–	–	–	–	–	–	–	(3,427,470)
Derecognition	(35,963)	–	(283)	–	(368)	–	–	–	(36,614)
Impairment – charged to SoCNE	–	(27,820)	(892)	–	(1,000)	(4,294)	–	–	(34,006)
Impairment – charged to revaluation reserve	–	–	(2,116)	–	(1,014)	(243)	–	–	(3,373)
Transfers	(19,473)	(27,743)	2,527	2,092	16,944	19,690	5,963	–	–
Reclassifications to assets held for sale	–	–	(2)	–	(1,919)	–	–	–	(1,921)
At 31 March 2020	142,731,330	131,586	182,337	235,191	73,470	163,610	11,262	73,145	143,601,931
Depreciation and impairment									
At 1 April 2019	14,992,724	–	–	129,349	–	139,183	3,634	–	15,264,890
Charged in year	1,138,471	–	–	7,534	–	9,756	1,363	9,460	1,166,584
Disposals	–	–	–	–	–	(17,018)	(597)	–	(17,615)
Revaluation	1,694,773	–	–	2,877	–	862	25	–	1,698,537
Valuation adjustments	(657,626)	–	–	–	–	–	–	–	(657,626)
Derecognition	(6,828)	–	–	–	–	–	–	–	(6,828)
Impairment	–	–	–	–	–	(4,263)	–	–	(4,263)
At 31 March 2020	17,161,514	–	–	139,760	–	128,520	4,425	9,460	17,443,679
Net book value									
At 1 April 2019	120,238,992	30,176	181,360	98,806	55,018	24,987	2,218	–	120,631,557
At 31 March 2020	125,569,816	131,586	182,337	95,431	73,470	35,090	6,837	63,685	126,158,252

	SRN and related AUC £000	Non SRN AUC £000	Land £000	Buildings £000	Dwellings £000	Plant and machinery £000	Information technology £000	Total £000
Cost or valuation								
Balance transferred in at 1 April 2018	129,611,089	34,958	181,417	221,448	50,427	153,010	3,349	130,255,698
Capital additions	2,730,350	77,419	–	–	–	–	–	2,807,769
Disposals	–	–	(30)	–	(361)	(279)	–	(670)
Revaluation	2,963,214	(44,563)	(3,530)	6,777	6,466	1,738	25	2,930,127
Derecognition	(72,354)	–	–	–	–	–	–	(72,354)
Impairment – charged to SoCNE	–	–	(161)	–	(363)	(24)	–	(548)
Transfers	(583)	(38,313)	2,374	–	–	9,725	2,478	(24,319)
Reclassifications to assets held for sale	–	675	1,290	(70)	(1,151)	–	–	744
At 31 March 2019	135,231,716	30,176	181,360	228,155	55,018	164,170	5,852	135,896,447
Depreciation and impairment								
Balance transferred in at 1 April 2018	14,731,381	–	–	126,045	–	126,806	2,834	14,987,066
Disposals	–	–	–	–	–	(279)	–	(279)
Charged in year	1,194,944	–	–	(644)	–	11,476	784	1,206,560
Revaluation	(918,051)	–	–	3,948	–	1,180	16	(912,907)
Derecognition	(15,550)	–	–	–	–	–	–	(15,550)
At 31 March 2019	14,992,724	–	–	129,349	–	139,183	3,634	15,264,890
Net book value								
At 1 April 2018	114,879,708	34,958	181,417	95,403	50,427	26,204	515	115,268,632
At 31 March 2019	120,238,992	30,176	181,360	98,806	55,018	24,987	2,218	120,631,557

6.2
SRN

	Roads £000	Land £000	Structures £000	Technology £000	AUC £000	Total £000
Cost						
At 1 April 2019	76,421,658	13,028,354	41,027,907	3,097,004	1,656,793	135,231,716
Capital additions	472,185	–	185,439	–	2,492,898	3,150,522
Revaluation	8,745,997	(257,287)	1,315,696	(26,660)	(1,288,122)	8,489,624
Functional valuation adjustment	(3,427,470)	–	–	–	–	(3,427,470)
Valuation adjustments	(472,187)	–	(185,439)	–	–	(657,626)
Disposal and derecognition	–	–	(32,225)	(3,738)	–	(35,963)
Transfers	316,985	4,181	52,140	96,783	(489,562)	(19,473)
At 31 March 2020	82,057,168	12,775,248	42,363,518	3,163,389	2,372,007	142,731,330
Accumulated depreciation						
At 1 April 2019	2,394,594	–	11,027,333	1,570,797	–	14,992,724
Charged in year	704,140	–	300,866	133,465	–	1,138,471
Revaluation	1,295,240	–	432,448	(32,915)	–	1,694,773
Valuation adjustments	(472,187)	–	(185,439)	–	–	(657,626)
Disposal and derecognition	–	–	(5,891)	(937)	–	(6,828)
At 31 March 2020	3,921,787	–	11,569,317	1,670,410	–	17,161,514
Net book value						
At 1 April 2019	74,027,064	13,028,354	30,000,574	1,526,207	1,656,793	120,238,992
At 31 March 2020	78,135,381	12,775,248	30,794,201	1,492,979	2,372,007	125,569,816

i) Valuation principles and methodology:

The company has chosen to value the network at fair value. Fair value is a rational and unbiased estimate of the potential market value of an asset at a particular point in time (in this case the company's year-end accounting reference date). Generally, the uplift on revaluation (the gain) is recorded in a revaluation reserve, subject to adjustments discussed at 6.2.iii.b below.

The SRN is a specialised asset and does not have an easily attainable market valuation or an income stream on which to base the valuation. The company therefore determines the fair value of the SRN using Depreciated Replacement Cost (DRC) in accordance with the guidance provided by the FReM. This approach is consistent with accounting standard IFRS 13 (fair value measurement) and calculates the value of the SRN to a theoretical buyer based on how much it would cost to construct a network of equivalent service potential. At a high level, the DRC estimate involves the calculation of an 'as new' replacement cost based on a modern equivalent asset offering the same function (which the company takes to include identical routing and capacity) on a greenfield site¹, before applying depreciation to reflect the current condition of the network.

Highways England undertakes a full valuation of each of the high-level SRN elements (roads, structures, land and technology) at intervals not exceeding five years. This valuation is undertaken with support from professional cost estimators and relevant experts on modelling and statistics. The five-yearly valuation, known as a quinquennial review (QQR), is undertaken in accordance with the general principles of the *Appraisal and Valuation Manual (Red Book)*² of the Royal Institution of Chartered Surveyors (RICS).

The QQR provides an opportunity not only to derive rates using the latest source data, but also to reconsider the methods used to value assets.

A QQR revaluation of pavements and lands was undertaken in 2019–20 with costing rates updated to reflect the prices being charged on schemes completed in recent years. This review implemented updates to roads and land rates to reflect the current market, as well as an update to the way depreciation is calculated. The net value of the assets has been adjusted to reflect the new calculation for depreciation and has been accounted for through the revaluation reserve. The impact of changes to the depreciation policy for pavements will not be felt until the year ended 31 March 2021.

In addition, changes to the lands compensation, preparation and supervision uplifts, uplifts to reflect the increased cost of implementing smart motorways and a new indexation policy have been implemented. As indexation, and preparation and supervision affect all asset types, the impact of the review has been seen across all the elements of the network. Full details about the changes to indices can be found in note 6.2.iii.b.

As part of the QQR a change in the depreciation methodology was implemented. Historically, only rutting data collected by the organisation was used to calculate the depreciation factor for pavements. The depreciation factor will now be calculated using rutting, fretting, texture and longitudinal profiles from condition survey results. The impact of this change is taken to reserves for 2019–20 and will impact the depreciation charge from 2020–21 onwards.

The next QQRs in relation to structures and technology are due in March 2023 and March 2024 respectively. In 2021 we will undertake a bottom up valuation of our special structures. Special structures are those which are unique to our network and for which it is difficult to obtain comparable costing information.

1 SRN is valued on the basis that replacement will be on a greenfield site. VAT is non-recoverable on 'greenfield site' expenditure and so the depreciated replacement cost is adjusted to include non-recoverable VAT at 20%.

2 The *Red Book* contains global mandatory rules, best practice guidance and related commentary for all cost estimators undertaking asset valuations and is clear that valuations for inclusion in financial statements must comply strictly with the financial reporting standards adopted by the company.

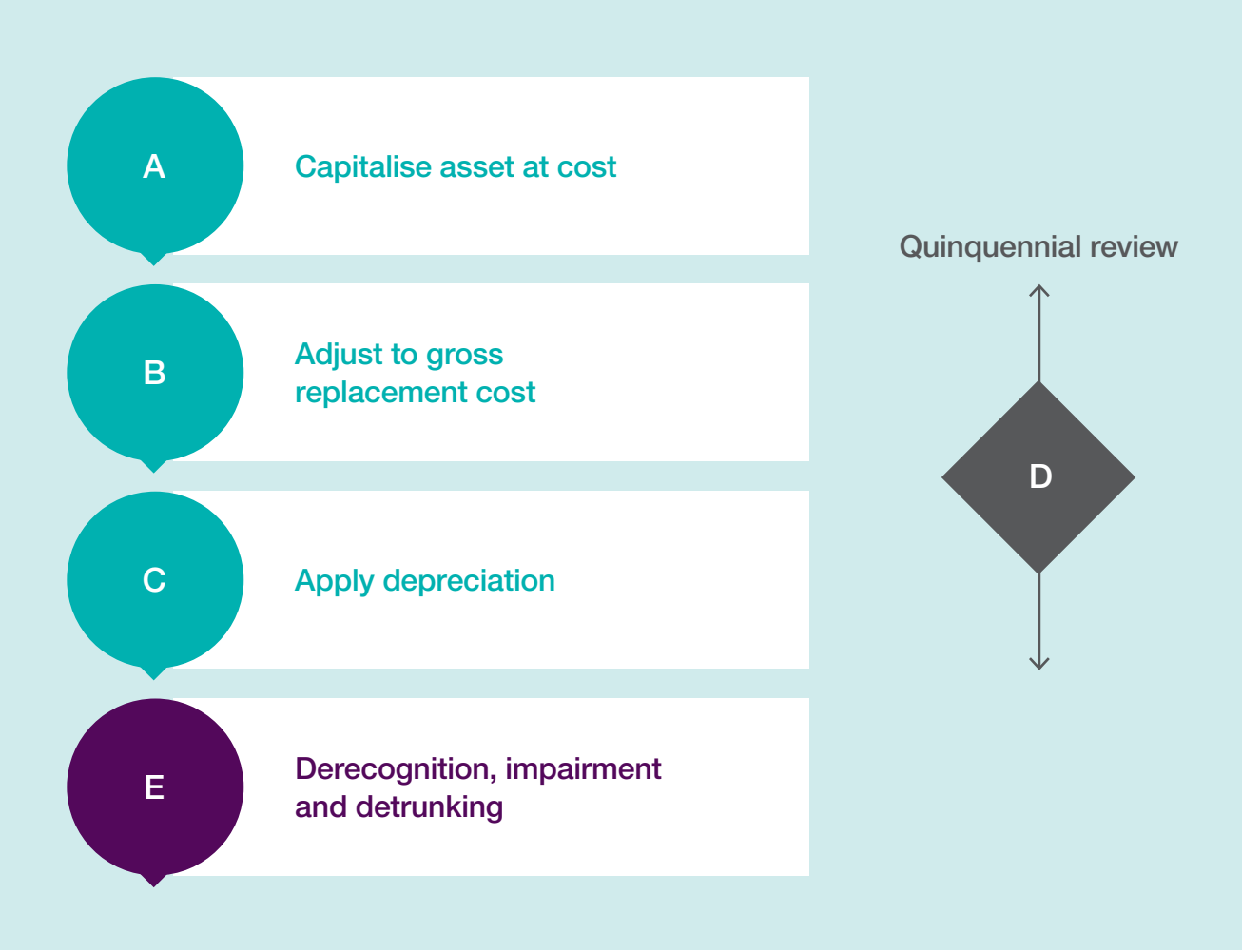
ii) Standard costing rates:

The SRN valuation is based on a standard cost model. A number of accounting assumptions are made when calculating the unit rates for the various elements of the SRN as part of the QQR process:

Unit cost	Measurement principles
Roads	<p>Standard costing for roads is based on 29 road types, each of which has a standard unit rate that is applied across the SRN for the relevant road type. Unit rates are generated from suitable schemes constructed over recent years that have opened for traffic.</p> <p>Where a road type is not represented by recent construction work, the company extrapolates data based on known costing relationships between road types.</p>
Land	<p>Land costing rates are determined for the SRN land parcels based upon values provided by the Valuation Office Agency. Parcels are identified and differentiated from each other by geographic location and classified as either urban or rural.</p> <p>Some land occupied by the SRN is not owned by the company, e.g. Crown land; however, as the company is entitled to use this land in perpetuity, it is included within the freehold value of the network.</p>
Structures	<p>For standard structures, unit rates are calculated based upon recently completed schemes. Bridges, tunnels, gantries and retaining walls are valued by applying unit rates to the scale of each asset, e.g. the span and width of bridges.</p> <p>Non-standard structures, such as the Dartford-Thurrock River Crossing, cannot be quantified and valued in the same manner as other structures due to the unique combination of their size, construction and character. For these assets, actual cost data and professional judgement are used to inform the valuation. Non-standard structures have a net value of approximately £2.2 billion.</p>
Technology	<p>For technology equipment (which includes, variable message signs, CCTV, automatic number plate recognition cameras, cabling, telephones and signal power supplies), unit costs are developed by the Highways England commercial team using rates from technology frameworks currently in place between the company and its contractors and bulk purchase prices for materials procured directly by the company.</p> <p>The unit costs for technology equipment include the cost of individual components, installation costs, commissioning costs, preparation and supervision costs, and traffic management costs where applicable.</p>

iii) Applying the valuation principles

At a high level, the process for valuing the SRN is as follows:



A

Capitalisation Policy (capitalise asset at cost):
Capital expenditure is the money that we spend on purchasing, renewing or improving our assets. There is no minimal value threshold for capitalisation of SRN expenditure. Costs are capitalised in accordance with the following policies:



Construction

All construction expenditure on schemes is capitalised.

Design costs are capitalised when the related scheme is included within RIS1 or RIS2, and where there is reasonable certainty the scheme will go ahead.

Where a scheme is later withdrawn from the capital programme, total design expenditure already incurred is written off and recognised in the Statement of Comprehensive Net Expenditure. Any remaining land and property is transferred to surplus land and buildings or dwellings.



Renewals and enhancements

The SRN is intended to be maintained at a specific level of service potential by continual replacement and refurbishment.

The SRN is inspected regularly to enable maintenance to be planned on a priority basis. Expenditure on the SRN is capitalised only for projects which extend the network’s service potential. This can either be done through enhancements, such as road widening schemes, smart motorway upgrades, new roads or structures, or renewal of the network including surface replacement works and major bridge refurbishments which extend the life of the network.

Maintenance expenditure, which represents day-to-day servicing such as pothole repairs or drainage clearance, is charged to the Statement of Comprehensive Net Expenditure as incurred.



Internal staff costs

Costs that can be directly attributed to the construction of an asset, including capital renewal schemes, are capitalised. Staff costs are capitalised by taking the ratio of capital spend to total programme spend for each directorate supporting the delivery of the capital works. This ratio is then applied to the total pay costs for each directorate.



Technology equipment

Expenditure on technology equipment is capitalised when the equipment is installed and commissioned on the SRN for the first time. This principally comprises variable message signs, CCTV and automatic number plate recognition cameras.

Capital additions
The company has invested £2,493 million on capital enhancements in the year. This includes investment in major projects, delivery of the designated funds programme and delivering safety and congestion relief schemes.

In addition, we have invested £657.6 million (2018–19 £648.5 million) in capital renewal schemes. Renewal schemes replace the service potential of the SRN and expenditure is therefore deemed capital expenditure. Renewal schemes are usually small (less than £10 million) and usually completed within six to 18 months. The most significant addition during the period was the continuing work on the M5 Oldbury waterproofing of £53.4 million.

B

Adjustments (adjust gross replacement cost):
Each sub-category of the SRN is valued using the standard costing rates identified by the QQR and then adjusted on an annual basis to reflect changes in underlying market conditions. The following adjustments are made to the revaluation reserve and are reflected in other comprehensive expenditure, to the extent that a revaluation surplus is available:

Adjustments to assets under construction (AUC): Highways England considers the SRN to be one asset. AUC are an integral part of the SRN and due to the physical and functional interdependence of the various elements of the network there is no distinction made between an asset constructed and an asset under construction. AUC are therefore accounted for on the same basis as any other asset subcategory.

AUC are capitalised at cost during construction. In line with RICS principles, the SRN is valued on the basis that the replacement would be on a ‘greenfield site’. Road schemes are mostly built on an existing road rather than ‘greenfield’ and this is more expensive because of the additional cost of traffic management, demolition and other site-specific costs. To provide a consistent valuation of the whole network, the company applies an annual ‘greenfield’ revaluation adjustment to AUC to bring it back to its depreciated replacement cost.

The company applies revaluation percentages, based upon project type, using projects built over the previous 10 years. This ensures that the valuation of the network is adjusted on an ongoing basis rather than only upon project completion.

Renewals-based adjustments: The valuation of the network is calculated based upon condition surveys (see ‘condition depreciation’ below). Renewals are performed to ensure that the condition of the network is maintained at a steady state. Renewals are not treated for accounting purposes as having an impact upon the valuation of the network because any related improvement in road condition will be reflected within the surveys. On this basis, for both the road and structures asset categories where there are in-year renewals, the value of the replaced asset elements are adjusted to have nil net book value.

Dimensional variance adjustments: Data quantifying the extent of the SRN is held on a number of internal operational asset management systems which are used to inform the valuation of individual roads and structures. With the use of increasingly accurate measuring technology, there can be changes to the measured length, width, and height of the road and structures when they are remeasured. When this happens, it impacts on the valuation of the SRN.

Indexation: Indices are applied in the years between QQRs to ensure the final valuation is at depreciated replacement cost. Indexation of the SRN valuation is applied as follows:

Unit cost	Indexation determination
Roads and structures	The Highways England Capital Enhancement Cost Index (HECI) is applied to roads and structures for the purposes of yearly revaluation. This is produced bi-annually by the Royal Institution of Chartered Surveyors and directly reflects the movement in prices experienced by the company ³
Land	Land indexation is determined by the company in consultation with external consultants and the following sources: <ul style="list-style-type: none">Urban land indices from the Land Registry House price indexRural land indices from the Royal Agricultural University (RAU)⁴
Technology	HECI is applied to all technology assets

Technical valuation adjustment: New technical requirements mean that concrete barriers are required on all ‘new’ roads. The gross valuation of the network is calculated on modern equivalent basis meaning concrete reservations are included as standard within the road rates. To reflect the fact that the network is composed of around 90% steel reservations, and not the higher costing concrete equivalent, an adjustment has been made to the gross cost for the cost differential between the two barrier types.

³ Historically the company has applied indexation in accordance with the Road Construction Resource Cost Indices (ROCOS). This reflects the movement in prices in the construction industry as a whole. This year, the company has opted to use the Highways England Capital Enhancement Cost Index (HECI) as a reflection of the direct impact of price movements on the company.

⁴ Historically the RICS Rural Land Market Survey has been used to index land. RICS are no longer producing this and, as the best alternative, we have selected to adopt the RAU rural land indices.

Revaluation

The SRN was revalued upwards by £3.4 billion (2018–19: £5.1 billion upwards revaluation). This comprises:

- The Road Construction Resource Cost Indices (ROCOS) index for the year has moved upwards from 261 to 263, an increase of 0.8% resulting in a £0.8 billion upwards revaluation.
- The network valuation is adjusted for location factors (except for non-structure technology assets and land), which are applied to costs to reflect the regional variations in construction prices. The regional BCIS (Building Cost Information Service) Tender Price Location Study Indices are used as location factors for the valuation. A significant reduction in the valuation of the network of £2.6 billion was a result of falls in this factor. The biggest falls were seen in the North East (5.2% decrease) and South East (6.2% decrease). This adjustment is necessary as the geographical distribution of the SRN is not uniform. Construction costs vary across the country, with higher costs seen where there is a geographical concentration in the SRN in the south-east and other metropolitan areas.
- During the financial year a full quinquennial review was undertaken on the pavements and lands elements of our network. The five-yearly review to pavements and land has led to a £9.9 billion increase to the net book value of the network. A number of changes were made to the rates and the methodology which have impacted on the valuation at year end.

Road Rates: Updated road rates were developed by Atkins, who reviewed actual cost data from major road schemes completed since the last road rate review. During the past five years, Highways England has completed very few schemes involving the construction of significant amounts of new pavement. A review of all completed schemes resulted in a list of seven potential schemes that may have sufficient new pavement to provide data on construction costs. Of these seven schemes, on analysing the detail only four were able to be carried forwards and used to actually calculate new rates. The other three schemes were discounted predominantly due to them being more complex brownfield development involving improvement works within the scheme whose costs could not be easily stripped out from the overall project costs. The actual construction costs of schemes do not represent the typical greenfield site assumption which is the basis for the calculation of the gross replacement cost. Therefore, often subjective, valuation judgements, assumptions and adjustments are made by our valuers in calculating the final rates.

The update to road rates has led to around a 7.4% increase in rate for each road design type.

Land Rates: Up to date land rates were provided by the Valuation Office Agency’s District Valuer Services (DVS) team. The rates are based on current market information from recent sales and are valued to reflect typical urban and rural values for each location. As the value of land can vary within an area, the valuer’s judgement has been used to determine what constitutes a typical parcel of land within each area.

On the advice of the DVS, we made a small variation to the geography of the land rates; these are now provided at a sub-regional level rather than at an upper-tier local authority level as was provided historically.

Further changes were made to how rural land is indexed due to the previous dataset no longer being produced by the RICS (see indexation table page 182).

The impact of these changes was around a 5% reduction in the valuation of land.

Smart Motorways: The Smart Motorway uplift was recalculated by Benchmark as our technical specialist in this area. This was based on up to date cost information from recently completed schemes. A bottom up approach is taken to calculating the extra-over cost of delivering a smart motorway as opposed to a standard motorway. This uplift is applied to the lengths of smart motorways across the network.

The smart motorway uplift increased by 38% from £700,613 per km (Q4 2020) to £970,157 per km (Q4 2020 QQR).

Indexation: An update has been made to the index used to uplift the rates between five-yearly revaluations.

Historically, the ROCOS index was used. However, RICS produce a bespoke index for Highways England, which is aligned to the types of construction that Highways England undertakes. It was agreed that this index would be used instead of the ROCOS index, given it is more aligned with the network.

The bespoke index is applied to all pavement and structure assets, and the majority of communications assets. This led to a 2.5% increase in the valuation of those assets impacted by the change in index.

Preparation & Supervision and Lands Compensation: A preparation and supervision uplift is required to cover the cost of preparatory works and supervision costs which are not specific to the cost of construction and as such is not factored in to the road rates. Likewise, the lands compensation uplift covers additional lands costs outside of the actual purchase cost of land that make up costs in a scheme. This mainly covers compensation but includes legal costs, surveyors etc.

The preparation and supervision and lands compensation percentages were updated to include the costs of the new basket of schemes used to calculate rates. A long-term average has been used for these percentages, aggregating the data from the 2010, 2015 and 2020 rates reviews as it was considered this best reflects the varied nature of the schemes delivered by the company and will provide a more accurate uplift, than one which is impacted by one off outliers.

The preparation and supervision uplift has increased by 3.33 percentage points, from 37.49% to 40.82%.

The lands compensation uplift has increased by 4 percentage points, from 65.0% to 69.0%.

Depreciation: A change in the depreciation methodology was implemented through the rates review. Historically, only rutting data collected by the organisation was used to calculate the depreciation factor for pavements. The depreciation factor is now calculated using rutting, fretting, texture and longitudinal profile TRACS survey results. By including additional condition metrics into the calculation, the depreciation of the network will be more aligned to asset maintenance and Key Performance Indicator 8.

The new depreciation methodology results in an increase in depreciation of £1.0 billion.

The net value of the assets has been adjusted to reflect the new calculation for depreciation and this has been accounted for in the revaluation reserve.

- SRN AUC capital additions are recognised at actual cost, but the value of projects is revised annually with the aim of approximating a depreciated replacement cost. The company uses a standard revaluation percentage for construction projects lasting more than one year based upon projects constructed over the previous ten years. For the year there were £1.3 billion of valuation adjustments (2018–19 £1.2 billion).
- Included within the revised QQR rates for pavements are the costs of central reservation barriers. In line with the current technical standard for barriers, these have been valued on the basis that they are constructed from concrete. This does not reflect the true composition of the network where approximately 10% of current central reservations are concrete with the remainder being constructed from metal or wire. As there is a significant difference between concrete and the other forms of central reservation designs both physically, and in build and future maintenance costs, it has been deemed appropriate under the RICS guidance to make a ‘technical valuation’ adjustment of £3.4 billion for this within the SRN valuation.

The table below covers the net movement on revaluation:

	SRN £000	SRN AUC £000	AUC £000	Other £000	Total £000
Revaluation – QQR	9,897,241	–	–	–	9,897,241
Revaluation – indexation	(1,526,154)	–	–	16,774	(1,509,380)
Revaluation – value reduction	–	(1,288,122)	64,522	(3,373)	(1,226,973)
Revaluation – dimensional variance	(288,114)	–	–	–	(288,114)
Technical valuation adjustment	(3,427,470)	–	–	–	(3,427,470)
	4,655,503	(1,288,122)	64,522	13,401	3,445,304



Depreciation (apply depreciation)

Depreciation is a measure of the value of an asset that has been consumed during the accounting period. It represents a loss in value caused by the use of the asset over the year and is charged to the Statement of Comprehensive Net Expenditure.

All parts of the SRN are depreciated, apart from land and the substructure of the road, which are deemed to have an unlimited useful life.

Road depreciation:

The renewable element of the road is subject to depreciation. This includes:

- Surface layer
- Drainage
- Road marking and studs
- Rigid concrete roads

These elements make up 17.5% of the gross replacement cost for the roads component of our network, the remainder being the cost of the land and substructure. For the purpose of depreciation, the road surface is recognised as a single asset and depreciation on these elements is calculated in two parts:

- **Renewals depreciation:** As described in 6.2.iii.b, the valuation of the SRN is calculated based upon condition surveys and renewals do not impact upon the valuation of the network. On this basis, we depreciate 100% of renewals expenditure in the year that it is incurred and account for this charge in net expenditure.
- **Condition depreciation:** Condition depreciation is currently based on rutting surveys. Rutting is a measurement of the deterioration of the wearable element of the road surface and is assessed using the Traffic Speed Road Assessment Condition Surveys (TRACS) performed by WDM and assured by TRL. Analysis of the actual condition of the road is compared to the carrying value of the road (after having applied renewals depreciation) and any movement is taken to net expenditure as a charge or credit to depreciation, depending on whether the condition has deteriorated or improved.

Structures depreciation:

In order to calculate the depreciation charge for structures, we take into account the life of the asset together with cost factors and condition.

Depreciation for structures is determined in two parts as follows:

- **Renewals depreciation:** As with roads, structures are valued based upon condition surveys. As any improvement in condition driven by renewals will be reflected in the results of these surveys, we depreciate 100% of renewals expenditure in the year that it is incurred.
- **Condition depreciation:** Structures are complex assets whose service life can be extended by the renewal of individual elements (reflected in an improvement in condition), and the depreciation methodology we use considers service life changes.

In 2018/19 the company refined and expanded its approach to condition depreciation which was previously calculated based upon straight-line depreciation over the economic life of the structural component parts.. This is the first year in which this new methodology, detailed below, will impact on structures depreciation values directly.

We depreciate structures by developing a depreciation factor based on the weighted average proportion of service life consumed for each structure. This is calculated based on the condition of each element of the structure using the Element Condition Score (ECS) from structure inspections. Full inspections take place every six years. Where condition improves, the score increases and where the condition deteriorates, the score decreases.

The ECS for each element is applied to a deterioration curve and averaged using a calculated replacement cost for each element. This results in a weighted average proportion of service life consumed which is then applied as a depreciation factor to the depreciable part of an asset's gross replacement cost (GRC).

Only the renewable elements of a structure are subject to depreciation (as with roads), and these elements have been assessed to make up 69.89% of a structure's GRC. The renewable elements include the substructure and superstructures, rails, fences and surface preparation such as waterproofing. Non-depreciable elements are primarily related to ground and earthworks, and expenditure incurred on preliminary work and mobilisation.

Technology depreciation:

The depreciation charge for technology assets is based on a 'straight line' depreciation methodology with the value reduced over the assets assigned life. The lifespan of technology varies between 15 and 50 years according to the type of equipment. The lifespan of the majority of equipment is 15 years. Technology assets with a lifespan of 50 years are typically structures to support the technology e.g. masts.

Depreciation charge

The depreciation charge over the year to 31 March 2020 was £1.1 billion (2018–19 £1.2 billion). This consists of:

- i) Pavement depreciation – being the decrease in the economic value of the road surface, was £704.1 million (2018–19: £567.3 million). This is made up of:
 - Renewals spend of £472.2 million (2018–19: £438.7 million) is used as the basis of an initial depreciation charge, based on the assumption that the network is maintained in a roughly steady state;
 - Analysis of road condition surveys provides evidence on the actual condition of the network which allows for more precise depreciation of the road surface – for the period ending 31 March 2020, surveys have increased the depreciation charge by £231.9 million (2018–19: charge of £128.5 million)
- ii) Structures depreciation – the SRN structures depreciation charge for the period was £300.9 million (2018–19: £493.9 million), of which £115.4 million represented a deterioration in the condition of structures on the network
- iii) Technology depreciation – £133.5 million (2018–19: £133.8 million) depreciation charge for the economic decrease in value of technology on the SRN



Derecognition, impairment and detrunking (disposals)

Derecognition: Elements of the SRN removed from service during the year are derecognised (i.e. removed from the financial statements) in line with accounting standard IAS 16 (property, plant and equipment) and the resulting loss on writing off the asset is charged to the Statement of Comprehensive Net Expenditure.

Impairment: Impairment refers to the permanent reduction in value of a company's assets below its carrying value as shown in the financial statements. The road surface and other SRN components are subject to an annual impairment review. Where they occur, impairments are recognised in line with IAS 36 (impairment of assets), by reducing the carrying value of the asset in the Statement of Financial Position and recognising a charge on the Statement of Comprehensive Net Expenditure to the extent that the impairment loss exceeds the available revaluation reserve.

Detrunking/trunking: During the accounting period the value of the SRN can be decreased by 'detrunking'. This is where a road/route is transferred from the company to a local authority. The value of the SRN can also be increased by 'trunking' when the company adopts a local authority road. Detrunking tends to occur when roads are superseded as part of the SRN following the construction of a new road. Such events are accounted for as a disposal for nil consideration. Trunking and detrunking are shown within the PPE notes as additions and disposals at the point that the asset is added or removed from the SRN.

Derecognition and disposals in year

Derecognition for the year from the SRN asset was £29.1 million (2018–19 £56.8 million). Residual derecognitions relate primarily to structures and communications technology removed from the SRN, often as a result of the upgrades required by the Smart Motorway Programme. For 2019–20, derecognition includes demolitions of structures on the A14 Cambridge to Huntingdon improvement scheme (£9.2 million), as well as two bridges on the M20 Junction 10a (£5.5 million). Other items include technology upgrades implemented as part of the Smart Motorway Programme. There were no detrunkings in the year.

The SoCNE presents the overall loss from derecognition and disposals which includes a loss of £0.4 million made on the sale of non-SRN assets (2018–19 £2.8 million profit).

6.3 Non-network assets

All assets which do not form part of the SRN are categorised as non-network assets. This includes land and buildings, plant and machinery, and IT equipment, which are accounted for as follows:



Capitalisation Policy (capitalise asset at cost):
All non-network assets above the minimum thresholds listed below are capitalised at cost.

Threshold	Element
Plant and machinery	£2,000
IT equipment	£2,000
Land and buildings	No minimum

Expenditure below these thresholds is charged as an expense to the Statement of Comprehensive Net Expenditure.



Valuation (perform annual revaluation)
Land and buildings: Freehold land and buildings are valued on the basis of open market value for existing use. External professional surveyors, in accordance with the (RICS) *Red Book*, undertake a full valuation of these assets at intervals not exceeding five years. Between valuations, values are adjusted with regional land and building indices calculated by our consultant engineers using rural land indices from the Royal Agricultural University (RAU) and average house price data from the Land Registry.

Asset	Valuation Date
Motorway maintenance compounds	31 March 2021
Motorway service areas	31 March 2021
Surplus properties (including dwellings)	31 December 2023
Regional Control Centres	31 March 2021
National Traffic Operations Centre	31 March 2021

Plant and machinery: Structural steelwork is stated at fair value using the current market value of steel. Other plant and machinery is stated at fair value using yearly plant and equipment indices supplied by the Office for National Statistics (ONS).
Information technology: Information technology consists of IT hardware and database development. Assets are stated at fair value using yearly plant and equipment indices supplied by the ONS.

Assets under construction: Non-network assets which are under construction at the period end are held at historical cost and are not subject to adjustment until after they have been completed and transferred to the appropriate asset category.



Depreciation (apply depreciation)
Freehold land is not depreciated. Other non-network assets are depreciated at rates calculated to reduce the assets' value over their expected useful lives on a straight-line basis as follows:

Asset Category	Asset Sub-category	Asset Lifespan
Land and Buildings	Freehold buildings	Up to 60 years
	Leasehold buildings	Length of lease
	Dwellings (non-surplus)	Not depreciated
Plant and Machinery	Winter maintenance equipment	10–25 years
	Office equipment	5–10 years
	Vehicles	5–10 years
Information technology	Structural steelwork	10 years
	Technology equipment	3–5 years
	Test equipment	5–10 years
	IT equipment	5 years
	Database development expenditure	5 years

Non-network asset balances
Land: Land consists of surplus land and land reserved for current and future road schemes. As at 31 March 2020, this includes motorway service areas land of £75.9 million (2018–19 £74.4 million), commercial land of £36.2 million (2018–19 £35.8 million), and motorway maintenance compounds land of £27.6 million (2018–19 £27.2 million).
Buildings: As at 31 March 2020, the net value of buildings includes motorway maintenance compounds of £55.4 million (2018–19 £49.5 million), regional control centres of £15.7 million (2018–19 £20 million), and commercial buildings at Dartford of £11.4 million (2018–19 £6.1 million).

Dwellings: As at 31 March 2020, the value of dwellings is £73.5 million (2018–19 £55 million). These are dwellings acquired under compulsory purchase orders as part of a scheme to enable construction.

This includes dwellings relating to the following schemes:

	31 March 2020 £m	31 March 2019 £m
M42 junction 3A widening	7.8	9.5
A6M Stockport North/South Bypass	7.3	6.7
M4 junction 4B – 8/9 widening	6.8	4.8
A57/A6928 Mottram, Hollingworth and Tintwhistle	5.6	6.4

Assets under construction (AUC)
The assets under construction (AUC) balance relates solely to non-network fixed assets. As the SRN is considered to be one asset, due to the physical and functional interdependence of it's component parts, AUC is recorded within the Strategic Road Network column within table 6.1.

i) AUC transfers
The company has transferred £27.7 million (2018–19 £39 million) of completed projects from non-network AUC to non-network assets. In addition a further £19.5 million of land and dwellings acquired as part of SRN schemes has been transferred as it is either surplus or for future use.

ii) Revaluation
Non-network AUC capital additions are recognised at actual cost. A review of prior year transactions identified that some of these capital additions had been valued downwards in line with the policy for the SRN as highlighted in note 6.2. Assets were revalued upwards by £64.5 million in year to correct this.

iii) Impairment
Within Non-network AUC there are some additions that do not provide a true asset to the company. This generally occurs in projects that provide wider support to the capital programme or maintenance work that is renewing an existing asset. Such items have been reviewed in year which has resulted in an impairment of £27.8 million.

6.4 Intangible assets

Intangible assets are assets which are without physical substance including computer software and licences. In line with IAS 38 (intangible assets), the company only recognises an intangible asset if it is probable that future economic benefits will be produced for the company and the costs can be measured reliably.

Intangible assets are measured initially at cost and are amortised on a straight-line basis over their useful lives, which are reviewed at the end of each reporting period. Licences over £2,000 are treated as intangible assets. Costs below this are expensed as they are incurred.

	Year to 31 March 2020 £000	Year to 31 March 2019 £000
Cost or valuation		
Opening balance	111,723	87,404
Disposals and derecognition	(39,814)	–
Transfer from AUC	–	24,319
Closing balance	71,909	111,723
Amortisation		
Opening balance	91,712	86,228
Charged in year	5,013	5,484
Disposals and derecognition	(39,814)	–
Closing balance	56,911	91,712
Net book value	14,998	20,011

Gross disposals and derecognition of £40 million have taken place in the year. This relates to the write off of obsolete software and systems, including the financial accounting system which has been replaced (£25 million).

The company has a number of bespoke databases that are fully amortised but continue to provide economic benefits. The databases will be updated or replaced at a future date. The most significant in-house databases by cost value are: ESDAL (abnormal loads management software), valued at £10 million (2018–19 £10 million); and NRTS 2 (National Roads Telecommunication Services), valued at £8 million (2018–19 £10 million).

6.5 Assets classified as held for sale

Non-current assets are classified as assets held for sale in accordance with IFRS 5 (non-current assets held for sale and discontinued operations) where they are available for sale in their present condition and are expected to be sold within one year. This comprises surplus land, buildings, dwellings, plant and machinery and other assets that are no longer in use. These assets are valued at the lower of their carrying amount and fair value (taken to be market value) less selling costs where material.

	Land and buildings £000	Dwellings £000	Total £000
At 1 April 2018	8,731	13,160	21,891
Disposals	(169)	(4,416)	(4,585)
Impairment – charged to SoCNE	(78)	(214)	(292)
Reclassifications (to)/from property, plant and equipment	(3,010)	2,266	(744)
At 31 March 2019	5,474	10,796	16,270
At 1 April 2019	5,474	10,796	16,270
Disposals	(1,964)	(4,118)	(6,082)
Impairment – charged to SoCNE	(25)	(122)	(147)
Reclassifications from property, plant and equipment	2	1,919	1,921
At 31 March 2020	3,487	8,475	11,962

Disposals in the year ended 31 March 2020 included the following sales:

- Tollgate Hotel site, Gravesend, Kent (£4.6 million)
- Walnut Tree Farm, Stockport, Manchester (£0.7 million)
- The White Lodge, Hindhead, Hampshire (£0.7 million)

Reclassifications of land and dwellings relates to the movement of items from property, plant and equipment that are expected to sell within the next year.

6.6 Inventories

	31 March 2020 £000	31 March 2019 £000
Communication/electrical equipment for the SRN	35,237	34,626
Salt	13,405	11,831
Other	563	534
	49,205	46,991

The inventory balance is composed of technology, salt, uniforms and steel and is valued at the lower of cost and the value that can be realised upon sale (net realisable value). The cost of inventories includes all costs incurred in bringing the items to their present location and the cost for valuation purposes is calculated on the basis of the weighted average cost of each category of inventory.

The communication/electrical equipment inventory includes variable messaging signs which are extensively used in the ongoing roll-out of smart motorway schemes across the SRN.

The company's salt stock includes reserves held for the English local highways authorities. This reserve is only for use as a last resort in the event of normal domestic salt supply channels being unable to meet the demands of local highways authorities. The salt is stored to protect it from leaching from rainfall. However, over time salt deteriorates and therefore the company's policy is to re-measure the holding each year, to reflect any loss from deterioration.

7 Financial assets and liabilities

A financial instrument is a contract between parties that gives rise to a financial asset of one entity and a financial liability of another entity. This note provides information about the company's financial instruments, including:

- an overview of all financial instrument assets and liabilities
- accounting policies
- information about determining the fair value of instruments

The company's exposure to risks associated with the financial instruments is discussed in note 10. The maximum exposure to credit risk at the end of the reporting period is the carrying amount of each class of financial assets mentioned below.

7.1. Cash

	Year to 31 March 2020 £000	Year to 31 March 2019 £000
Balance at start of the year	16,395	18,722
Net change in cash	(15,633)	(2,327)
Balance as at end of the year	762	16,395
The following balances were held at:		
Commercial banks	323	291
Government banking service	439	16,104
	762	16,395

The company does not hold any cash equivalent balances. Cash comprises bank balances held with the government banking service and commercial bank accounts. Cash reserves were run down at the year-end to pay suppliers in line with our prompt payment targets.

7.2 Trade and other receivables

	31 March 2020 £000	31 March 2019 £000
Amounts falling due within one year		
Trade receivables		
Receivable from contracts with other customers	7,173	4,825
Receivable from contracts with local authorities	4,673	3,228
Receivable from agreements with government	1,458	298
Deposits and advances	41,570	16,400
VAT	203,556	134,538
Prepayments and accrued income		
Receivable from contracts with other customers	12,368	7,874
Receivable from contracts with local authorities	1,480	4,983
Receivable from agreements with government	61	708
Other receivables	79	118
	272,418	172,972
Amounts falling due after more than one year		
Prepayments and accrued income	10,569	11,854
	10,569	11,854
Total receivables	282,987	184,826

- i) **Trade receivables** are amounts due from customers for goods sold or services performed in the ordinary course of business which can include third party claims, third party projects (S278), former tenants and employee overpayments.
- ii) **Deposits and advances** primarily relate to advances to third parties for project-related prepayments such as payments to statutory undertakers⁵, as well as season ticket loans to employees. This balance includes payments for the M4 J3 to 12 smart motorway rollout where a new phase of the scheme has begun and the A30 Chiverton to Carland Cross scheme where work is due to commence. Advances to statutory undertakers have increased in year including an £8m increase on the A303 Amesbury to Berwick Down.
- iii) **VAT:** The increase in VAT balances is driven by increased activity within the company during the year as well as some outstanding input VAT that is yet to be claimed.
- There are some areas of judgement surrounding VAT recovery which are discussed within note 9.4.
- iv) **Prepayment and accrued income** balance includes third party contributions to schemes, minor occupier income and property prepayments for offices, depots and buildings used by the company.

Due to the short-term nature of the current receivables, their carrying amount is considered to be the same as their fair value.

The policy surrounding the impairment of financial assets is covered in note 18.9 impairment on page 204.

7.3 Trade and other payables

	Note	31 March 2020 £000	31 March 2019 £000
Amounts falling due within one year:			
Taxation and social security		10,201	9,257
Trade payables		73,158	48,005
Accruals		632,879	554,942
Deferred income			
Receivable from contracts with other customers		17,580	16,340
Receivable from contracts with local authorities		17,748	13,317
Receivable from agreements with government		25,433	5,553
Capital element under on balance sheet PFI contracts	7.5.2	81,207	82,935
Future lease commitments	7.5.1	11,645	–
Other payables		43,220	43,492
		913,071	773,841
Amounts falling due after more than one year:			
Capital element under on balance sheet PFI contracts	7.5.2	1,352,044	1,366,705
Future lease commitments	7.5.1	52,884	–
Deferred income		21,073	37,119
Retentions		436	419
		1,426,437	1,404,243
Total payables		2,339,508	2,178,084

- i) **Taxation and social security** covers employer liabilities such as income tax, national insurance and corporation tax commitments.
- ii) **Trade payables** are amounts owed to suppliers for goods or services provided to the company.
- iii) **Accruals** recognise expenses that have been consumed that have not been paid for. Accruals are needed to ensure that all expenses (and revenues) are recognised within the correct reporting period so that the amount of revenue, expense, and profit or loss in a period reflects the actual level of economic activity within the company.
- iv) **Deferred income** occurs when an entity has received income in advance of it being earned and it is deferred until it has been earned. This can include scheme contributions and rent in advance from minority occupiers.
- v) **Capital element under on balance sheet PFI contracts** reflects the outstanding capital liabilities in relation to longstanding service concession arrangements with private sector entities.
- vi) **Future lease commitments** relate to buildings used by the company.

5 Statutory undertaker is a legal term used to describe those organisations and agencies that have certain legal rights and obligations when carrying out particular development and infrastructure work. Typically, they are utilities and telecoms companies.

7.4 Provisions

In line with accounting standard IAS 37 (provisions, contingent liabilities and contingent assets), the company provides for legal or constructive obligations that are of uncertain timing or amount at the Statement of Financial Position date, but where it is more likely than not that a liability exists. The measurement of the provision is based upon the best estimate of the expenditure required to settle the obligation.

	Land and property acquisition £000	Engineering and construction £000	Leased assets £000	Early retirement pension £000	Other £000	Total £000
At 1 April 2018	154,990	–	–	97	11,076	166,163
Provided in the year	178,009	100,303	–	–	9,088	287,400
Provisions not required written back	(48,233)	(2,381)	–	–	(6,684)	(57,298)
Provisions utilised in the year	(51,747)	–	–	(42)	(2,518)	(54,307)
At 31 March 2019	233,019	97,922	–	55	10,962	341,958
At 1 April 2019	233,019	97,922	–	55	10,962	341,958
Provided in the year	163,364	117,880	784	–	6,003	288,031
Provisions not required written back	(87,378)	(41,916)	–	–	(6,660)	(135,954)
Provisions utilised in the year	(71,439)	(129,500)	–	(36)	(3,474)	(204,449)
At 31 March 2020	237,566	44,386	784	19	6,831	289,586

Analysis of expected timing of discounted flows:

	Land and property acquisition £000	Engineering and construction £000	Leased assets £000	Early retirement pension £000	Other £000	Total £000
Not later than one year	113,430	44,386	–	19	6,039	163,874
Later than one year and not later than five years	124,136	–	–	–	443	124,579
Later than five years	–	–	784	–	349	1,133
	237,566	44,386	784	19	6,831	289,586

Land and property acquisition: These provisions relate principally to the estimated cost of planning blight, discretionary and compulsory acquisition of property and compensation for property owners arising from physical construction of a road scheme. It may take several years from the announcement of a scheme to completion of the road and final settlement of all liabilities.

Planning blight occurs when the value of a property is substantially reduced because of a proposal to carry out works. We are liable for, and have the ability to, purchase affected property and recognise the liability arising from the requirement to purchase blighted properties at the point of the preferred route announcement (PRA). At the point that the PRA is announced we have a legal obligation for blight under the Town and Country Planning Act 1990 and a constructive obligation under our own policy and our past behaviour. Following PRA the company considers that avoidance of blight liability is not within our control and as such we have no realistic alternative to settling the obligation.

Parliament has given us the ability to purchase land so that we can carry out infrastructure developments that are in the public interest. Our policy is to recognise the liability for these compulsory purchases at the point a Development Consent Order (DCO) or Compulsory Purchase Order (CPO) is made. A CPO provides the company with the statutory right to purchase property within the confines of the scheme presented within the order and as such creates a constructive obligation. Following CPO the company considers that avoidance of related liability is not within our control and as such we have no realistic alternative to settling the obligation.

Compensation can be claimed by people who own and also occupy property that has reduced in value by physical factors caused by the use of a new or altered road. The liability can arise from noise, smell, lighting etc. and we provide for this compensation (known as Part 1 claims) at the commencement of construction. We consider that commencement of construction triggers a constructive obligation as at this point a valid expectation is created that compensation will be paid to impacted parties.

At the 31 March 2020 we held £90 million of blight provisions, including £43 million relating to the Lower Thames Crossing, £119 million DCO/CPO provisions, including £40 million on the A14 Cambridge to Huntingdon scheme, and £29 million relating to Part 1 claims. It may take several years from the announcement of a scheme to completion of the road and final settlement of all liabilities.

Engineering and construction: Prior year provisions related to an outstanding judgement surrounding VAT recovery rates on the construction phase of Hybrid⁶ schemes. These have now been settled.

The current year provision relates to the over-recovery of VAT on Hybrid scheme preliminary works. In order to settle any liability, the company will work with HMRC to clarify the application of Contracted Out Services (COS) headings⁷ in relation to preconstruction works.

6 Hybrid schemes are those schemes which take place partially within and partially outside of the network boundary. They are significant as the company can only recover VAT on construction work which takes place on the existing SRN.

7 COS headings refer to tax directions issued by HMRC to allow for VAT recovery on some COS. Government organisations have been encouraged to contract out services to the private sector which would have traditionally been performed in-house. Many of these services are subject to VAT and, where they are acquired for 'non-business' purposes, the non-reclaimable VAT could act as a disincentive to contracting-out. COS headings exist to remove any disincentive.

Leased assets: Provisions relate to the potential cost of reinstating leased buildings back to their original condition at the end of the lease.

Early retirement pension: Relates to pension liabilities for former staff that left employment before the formal retirement age of 60. Highways England is responsible for making payments to the pension plan until their retirement age.

Other: Other provisions include those to third parties who have suffered damage or injury as a result of the road network being damaged and are entitled to submit a claim to Highways England for compensation. A provision is made which estimates the value of claims received as at 31 March 2020 that will require settlement by Highways England.

Provisions provided in year and not written back reconciles as follows:

	Year to 31 March 2020 £000	Year to 31 March 2019 £000
Provisions provided in year	288,031	287,400
Less provisions written back	(135,954)	(57,298)
Net provisions expenditure	152,077	230,102
Split as follows:		
Resource expenditure	26,789	45,443
Capital expenditure	124,504	184,659
Leased asset expenditure	784	–
	152,077	230,102
Provision for doubtful debt	1,034	1,062
Other provisions provided for in year	26,783	45,354
Total provision charge to the SoCNE	27,817	46,416

7.5 Financial instruments

7.5.1 Commitments under leases

IFRS 16 leases has been implemented during the period using the cumulative catch-up method; as a result comparatives are not restated. See note 19 for information surrounding the adoption of this standard.

	31 March 2020 £000
Lease liabilities	
Balance as at start of year	–
Recognised under IFRS 16	64,150
Additions in year	12,590
Repayment of lease liability	(13,603)
Interest on leases	1,392
Balance as at end of year	64,529
Amounts falling due	
No later than one year	11,645
Later than one year and not later than five years	31,942
Later than five years	20,942
	64,529

The company leases many assets including buildings and vehicles.

At the commencement of a lease (or the IFRS 16 transition date, if later), the company recognises a right-of-use asset and a lease liability.

The lease liability is measured as the payments, net of value added tax, for the remaining lease term, discounted either by the rate implied in the lease, or, where this cannot be determined, the incremental cost of borrowing is the rate advised by HM Treasury. The company does not typically undertake external borrowing and is instead funded annually by the Department for Transport which draws down its funding from the Exchequer. The company’s incremental borrowing rate is therefore advised by and aligned to the Treasury rate.

The right-of-use asset is measured at the value of the liability, adjusted for: any payments made before the commencement date; lease incentives received; incremental costs of obtaining the lease; and any disposal costs at the end of the lease. However, where the lease requires nominal consideration (a type of arrangement often described as a ‘peppercorn’ lease), the asset is measured at its existing use value.

The asset is subsequently measured using the fair value model. The company considers that the cost model is a reasonable proxy for the fair value model for leases of items other than land and property, and for leases of land and property with regular rent reviews. For other leases, the asset is carried at a revalued amount.

The liability is adjusted for the accrual of interest, repayments, reassessments and modifications.

The company has adopted the practical expedient to exclude initial direct costs from the measurement of the right-of-use asset at the date of initial application for transitioned leases.

Leases which are considered to be low value, or have an expected length of less than a year, are not recognised under IFRS 16 and the related costs are shown in the SoCNE.

7.5.2 Commitments under PFIs

The company has longstanding service concession arrangements with private sector entities to develop, build, finance, operate and maintain infrastructure and deliver services directly or indirectly to the public. Highways England controls or regulates the services provided and controls any significant residual interest in the infrastructure.

The company recognises the infrastructure associated with service concessions as an asset and recognises the related liability. The asset is accounted for in the same way as other assets of that type. Interest on the liability and expenditure on services provided under the service concession are recognised in the net operating expenditure as they accrue under the contract. The annual payments are apportioned between three elements: an element to pay for services; an element to pay interest on the liability; and an element to repay the initial liability.

The asset and liability are both initially recorded at the fair value of the property and the asset is subsequently revalued and depreciated in accordance with accounting policies for property, plant and equipment: see note 6.1.

The substance of the PFI contract under IFRIC 12 (service concession arrangements) is that the company has a finance lease, with the asset being recognised as a non-current asset of the company.

The total payments on balance sheet PFI contracts for which the company is committed are given in the tables below, analysed according to the year in which the commitment expires.

PFI	Contract start date	Duration in years	Initial capital value £m	Closing balance obligation £m	Service charge commitment £m
M40 Denham to Warwick	06/01/1997	30	71.2	29.3	293.8
A19 Dishforth to Tyne Tunnel DBFO	24/02/1997	30	47.8	19.6	322.9
A30/A35 Exeter to Bere Regis	01/10/1996	30	135.1	50.3	4.3
A1(M) Alconbury to Peterborough	01/04/1996	30	192.3	70.5	85.0
A419/A417 Swindon to Gloucester	01/04/1996	30	104.6	37.9	55.9
A50/A564 Stoke to Derby link	01/07/1996	30	37.3	15.1	70.4
M1-A1 Yorkshire link	01/07/1996	30	395.4	143.1	5.6
A69 Carlisle to Newcastle	01/04/1996	30	19.6	7.1	75.3
A1(M) Darrington to Dishforth	07/05/2003	33	236.4	172.8	507.7
A249 Iwade to Queenborough	01/04/2004	30	92.8	65.4	130.5
M25 London Orbital Motorway contract	01/05/2009	30	906.0	822.2	6,215.7
Total			2,238.5	1,433.3	7,767.1

During the year all models were reviewed to ensure that the end of the obligation was correctly reflected. Amendments have been required to the current obligation, the effect of this has been accounted for in year by adjusting the level of interest, service payment and capital repayment.

Recognised fair value measurements

For PFI obligations not carried at fair value, there is no active market for them, and it is not possible to make a reliable estimate of fair value. The company has no intention of disposing of these obligations. Accordingly, it has not disclosed a fair value for these obligations. For other financial assets and liabilities, the carrying value is a reasonable approximation of fair value.

Imputed finance lease charges under on balance sheet PFI contracts comprise:

	31 March 2020 £000	31 March 2019 £000
Not later than one year	181,982	184,970
Later than one year and not later than five years	727,928	734,446
Later than five years	1,539,375	1,618,194
	2,449,285	2,537,610
Less interest element	(1,016,034)	(1,087,970)
	1,433,251	1,449,640

Capital element under on balance sheet PFI contracts comprise:

	31 March 2020 £000	31 March 2019 £000
Not later than one year	81,207	82,935
Later than one year and not later than five years	380,604	381,945
Later than five years	971,440	984,760
	1,433,251	1,449,640

The total amount charged in the SoCNE in respect of the repayment of the capital element of the PFI transactions for the year to 31 March 2020 was £16.4 million (2018–19 £77.8 million).

Interest element under on balance sheet PFI contracts comprise:

	31 March 2020 £000	31 March 2019 £000
Not later than one year	100,775	102,035
Later than one year and not later than five years	347,323	352,500
Later than five years	567,936	633,435
	1,016,034	1,087,970

The total amount charged in the SoCNE in respect of interest on balance sheet PFI transactions for the year to 31 March 2020 was £134.7 million (2018–19 £109 million).

7.5.3 Details of the minimum PFI service charge to SoCNE:

	31 March 2020 £000	31 March 2019 £000
Not later than one year	400,760	330,768
Later than one year and not later than five years	1,623,864	1,537,621
Later than five years	5,742,517	6,252,897
	7,767,141	8,121,286

The total amount charged in the SoCNE in respect of the service element of on balance sheet PFI transactions for the year to 31 March 2020 was £348.4 million (2018–19 £277.0 million).

8 Equity and reserves

	31 March 2020 £	31 March 2019 £
Authorised		
10 ordinary shares at £1 each	10	10
Allotted, called up and fully paid		
10 ordinary shares at £1 each	10	10

Reserves

As the company generates minimal income, DfT provides funds annually in the form of a cash contribution, on behalf of the Secretary of State for Transport as the sole Shareholder of the company. The funds received are used to finance expenditure that supports the objectives of the company in accordance with the company’s licensing terms. These funds are allocated to the retained earnings reserve, along with the company’s net expenditure. At the start of operations on 1 April 2015, the company received a transfer from the Secretary of State for Transport comprising the assets of the Highways Agency, including the SRN (with the exception of the Severn Bridge and M6 toll road).

In accordance with generally accepted practice in respect of common control transactions, the net assets from this transfer were credited at book value to the revaluation reserve to the extent of the revaluation surplus available in the Highways Agency at the point of transfer; and for the balance, to a capital contributions reserve. Intra-reserve transfers relating to revaluation are posted against the capital contributions reserve since they relate in the main to the transferred-in network asset.

All reserves are non-distributable other than to the Secretary of State for Transport within the legislative framework and as defined by the Companies Act 2006.

RISK

Accounting judgements and estimates

9 Critical accounting judgement and key sources of uncertainty

A series of estimates and judgements are used to produce these financial statements. These estimates are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below.

9.1 Property, plant and equipment

The SRN is valued using an approach to determine depreciated replacement cost, as described in note 6.2.i. The valuation is built up using: an understanding of the extent of the network and its component parts on a modern equivalent basis; the application of a number of costing rates for those component parts, by type; and the condition of the network. In this context, it is sensitive to a number of significant areas of estimation, including the following:



Costing rates

Costing rates used to inform the valuation of roads and structures are based upon schemes constructed by the company in recent years. At each full revaluation (QQR), costing rates are derived for specific asset types, for example bridges are classified by their length and width. For some specific asset types there may be a limited number of schemes which provide a direct comparator. In these cases the company derives a costing rate through a line of best fit approach applied to a broader asset type (e.g. bridges) using available scheme data and known costing relationships between asset types. This provides a complete set of data points based upon the best available information.

This approach requires estimation but the company is satisfied that uncertainty is minimised by making use of the full available information. The impact of this approach is minimised as direct comparators are easily obtainable for common network features.

A 1% change in costing rates would materially impact the valuation of the SRN.



Indices

The company applies a number of construction-related indices to the costing rates for various elements of the SRN, both as part of the full revaluation exercises (QQRs) and to revalue the overall SRN components in interim valuation years. The company chooses indices which it judges most relevant to the replacement costs of the SRN’s component parts. Information on specific indices is found in note 6.2.ii.b.

During 2019–20, a review of indices was undertaken and annual indexation was changed from the Resource Cost Index of Road Construction (ROCOS) to the Highways England Capital Enhancement Cost Index (HECI). This index is specific to the costs incurred on projects at Highways England. HECI has been adopted for roads, structures and technology assets. The Impact of this change on new costing rates (roads only) was £2.1bn. Land is indexed in alignment with urban and rural land indices in conjunction with rural land indices from the RAU.

The network valuation is sensitive to indices. An increase in HECI of 10 points would impact the valuation of the network by £10.7 billion net.



Condition factors

Road surface condition determines the in year depreciation charge for the roads component of the SRN. It is analysed using surveys carried out on all lanes of the SRN that measure, at 10 metre intervals, the level of rutting (grooves in the road surface caused by wear and tear or deformation over time). Condition surveys are carried out on the whole of the network annually with the equipment used being quality assured every three months

Structures condition is reflected in the carrying value of the SRN structures element, which is in turn influenced by a depreciation charge based on an asset valuation model. This builds in both the impact of deterioration over time and periodic renewal as set out in note 6.2.iii.c. The company keeps information on the condition of its structures under regular review to assess whether an adjustment is required for depreciation to reflect an engineering assessment of the current condition point. Full structural inspections are only completed every 6 years and, due to a systems upgrade, structures data was only available as at October 2019.



Uplifts/adjustments

Preparation and supervision and Lands Uplifts: Valuation uplifts are required to account for costs incurred on projects which are not specific to construction or the purchase price of land (see 6.2 b). These uplifts are calculated using the same basket of schemes used for road rate calculations and a long-term average is used to calculate uplift percentages.

A 1% change in P&S or a 16% movement in lands uplift would materially impact the valuation of the network.

Technical valuation adjustment: New technical requirements mean that concrete barriers are required on all “new” roads. To reflect the fact that the network is composed of around 90% steel reservations an adjustment has been made. A value of £295,000 per km has been calculated by our technical experts as the bottom up cost difference between installing concrete and steel central reservation barriers on a greenfield site.

A 35% change in the concrete valuation adjustment would materially impact the network valuation.

9.2 Cost of Work Done (COWD)

The additions to property, plant and equipment are valued using an estimate of the cost of work done in the year to 31 March 2020. To the extent that the COWD is greater than the invoiced amount, a PPE addition and a corresponding accrual (note 7.3) are recognised on the basis of expected amounts required to settle contractual obligations. COWD assessments are based on information readily available to project managers on the status of works, but some estimation uncertainty is involved in the year-end measurement, in respect of the evaluation of how contractual dispute positions are likely to resolve, and in measuring the value of works performed at the year-end date.

9.2 Legal claims

Legal claims are recorded as contingent liabilities or provisions when the company faces legal claims and challenges, which may result in the possible outflow of economic benefits. The classification of these, as well as their valuation and presentation as current or non-current, is based on legal advice.

9.3 Land and property

Provisions: Land and property are acquired as necessary as part of the company’s work to improve the network. During the early stages of a project, until the preferred route is announced, potential blight claims are treated as remote and are not disclosed. After the preferred route announcement is made until the point of purchase they are treated as provisions. Potential acquisitions relating to land and property are not disclosed (due to the level of uncertainty over whether the land will be acquired) until the issue of a compulsory purchase order (CPO) or a development consent order (DCO) at which point a provision is recognised. The valuation of these provisions is provided by the Valuation Office Agency using their professional expertise to make the relevant estimation. As with all land valuation this estimation considers factors such as geographical location and land classification (urban/rural).

Non-SRN property valuation: In respect of non-SRN land and buildings, the company’s holdings are dominated by industrial land and, to a lesser extent, buildings in industrial settings. These have been indexed from previous revaluations in year, which provides the best estimate of their current value. The company considers, having reviewed post year end evidence from professional advisers, that while the coronavirus pandemic has resulted in a reduced transaction volume and heightened market uncertainty in property markets overall, this does not constitute a material uncertainty in the context of these overall accounts. As well as noting the exceptional variations which would be needed to materially affect the position, e.g. 37% in the case of industrial land, the company notes the relative stability and resilience of industrial property markets reported by real estate firms post year end. In addition, the company’s sites are in many cases (e.g. motorway service areas) used for purposes associated with road travel, which has seen a significant recovery in activity levels since the height of the UK lockdown.

9.4 Irrecoverable VAT

During 2018–19, HMRC undertook an investigation into recoverable VAT in relation to our Hybrid schemes. As part of this investigation, HMRC clarified their position that VAT is only recoverable in relation to works on the existing SRN and is not recoverable for greenfield sites or structures. Taking this guidance into account, the company has reassessed the recoverable VAT on all major schemes. These assessments have been performed by the Commercial and Procurement team and are based upon the initial scheme estimations with greenfield sites and structures removed to assess recoverable VAT. As these calculations are internally generated, VAT rules are open to interpretation and HMRC can assess up to four years of VAT charges, VAT remains a significant area of judgement.

10 Financial risk management

IFRS 7 (disclosure requirements) requires minimum disclosures about the nature and extent of credit risk, liquidity risk and market risk that the company faces in undertaking its activities. Due to the largely non-trading nature of its activities and the way in which government entities are financed, the company is not exposed to the degree of financial risk faced by many business entities. Moreover, financial instruments play a much more limited role in creating or changing risk than would be typical of the listed companies to which IFRS 7 mainly applies. The company has no powers to borrow or invest surplus funds.

Financial assets and liabilities are generated by day-to-day operational activities and are not held to change the risks facing the company in undertaking its activities. Nevertheless, the company’s Board of Directors has overall responsibility for the establishment and oversight of the company’s risk management framework. The core operations of the company are resourced largely from funds voted by Parliament and so has limited dependency on revenues from customers. This substantially reduces many financial risks.

10.1 Credit risk

Credit risk is the risk of suffering financial loss, should any of the company’s customers or counterparties fail to fulfil their contractual obligations to the company. Some of the company’s customers and counterparties are other public sector organisations. No credit risk arises from these organisations since the receivables are backed by the government. For those customers and counterparties that are not public sector organisations, the company has policies and procedures in place to ensure credit risk is kept to a minimum.

The carrying amount of financial assets represents the maximum credit risk exposure. Receivables are impaired on the basis of either ageing by receivable type or where a specific receivable is deemed to be recoverable or irrecoverable, based on the information available.

The following table provides an overview of the ageing profile of the financial assets comprising trade and other receivables.

	31 March 2020 £000	31 March 2019 £000
Ageing of financial assets		
Neither past due nor impaired	281,892	184,133
Past due 1–30 days	517	144
Past due 31–60 days	174	95
Past due 61–90 days	61	127
Past due >90 days	343	327
	282,987	184,826

10.2 Liquidity risk

Liquidity risk is the risk that the company is unable to meet its obligations when they fall due. The company’s approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions. The company’s policy is to determine its liquidity requirements by the use of short-term cash flow forecasts. These forecasts are supplemented by the government’s long-term commitment under the RIS.

The company believes that its contractual obligations, including those shown in commitments and contingencies in notes 15, 7.5.1, 7.5.2 and 12c can be met in the short term from existing cash and other current assets, and the funding it receives annually that is voted by Parliament. The longer term needs are met from the funding commitment provided by the government through the RIS.

	31 March 2020			31 March 2019	
	Not later than one year £000	Later than one year and not later than five years £000	Later than five years £000	Total £000	Total £000
Contractual cash flows					
Non-derivative financial liabilities					
Trade payables	716,238	–	–	716,238	647,414
Future lease commitments	11,645	31,942	20,942	64,529	–
Finance lease liabilities (PFIs)	81,207	380,604	971,440	1,433,251	1,449,640
Other non-interest bearing liabilities	103,981	21,509	–	125,490	81,030
	913,071	434,055	992,382	2,339,508	2,178,084

10.3 Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates and interest rates, will affect the company’s income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures where these are considered to materially impact the business and operations of the company.

10.4 Interest rate risk

This is the risk that the company will suffer financial loss due to interest rate fluctuations. The company’s financial assets and its financial liabilities carry nil or fixed rates of interest, therefore the company is not exposed to significant interest rate risk.

10.5 Exchange rate risk

This is the risk that the company will suffer financial loss due to changes in exchange rates. The company undertakes a small number of foreign currency transactions primarily in Euro and is not exposed to significant exchange risk. Given the quantum of transactions in foreign currency, the company has assessed that a strengthening or weakening of Euro will not have any significant impact on the financial statements.

11 Going concern

The Statement of Financial Position (SoFP) as at 31 March 2020 shows net current liabilities of £742.6 million. The company’s liabilities due to be settled after 31 March 2020 will be paid for through funding from the company’s sponsoring department: DfT. The company’s 2020–21 funding has been included in HM Treasury’s Main Estimate which has been approved by Parliament.

The Directors have a reasonable expectation that the company has adequate resources to operate for the foreseeable future. The financial statements are therefore prepared on a going concern basis.

In forming this view the Directors/management have:

- 1) reviewed the company’s future funding commitments received from the Government through the publication of RIS2, which sets out the £27.4 billion resource and capital funding that the company will receive during the five years from 2020–21 to 2025–26
- 2) kept DfT fully aware of commitments made which stretch beyond the period covered by RIS2
- 3) reviewed internal budgets, plans and cash flow forecasts
- 4) reviewed DfT’s Main Estimate for 2020–21

UNRECOGNISED ITEMS

The following items are disclosed in the accounts but not recognised in the financial statements.

12 Contingent liabilities disclosed under IAS 37

A contingent liability is a potential liability that may occur depending on the outcome of an uncertain future event; they do not meet the criteria for a provision. Unless their likelihood is considered to be remote, the company discloses them as contingent liabilities.

Under IAS 37, contingent liabilities are not recognised in the statement of financial position but are required to be disclosed in a note to the accounts.

	31 March 2020 £000	31 March 2019 £000
Land and property acquisition	–	1,137,934
Other	10,173	24,793
	10,173	1,162,727

12.1 Land and property acquisition

During the year the company has changed its policy with regards to the disclosure of contingent liabilities relating to land and property acquisitions which has resulted in the removal of all Land and Property balances from disclosure. For details of this change see note 21.2.

12.2 Other

Other contingent liabilities include partial claims from third parties who have suffered damage or injury as a result of the SRN being damaged, and a number of arbitration cases in respect of contractual claims for engineering and construction services. These claims are estimated based on prior years’ experience.

The historic estate assets which are held by the Secretary of State for Transport, together with any related contingent liabilities, are included in DfT’s accounts.

13 Contingent assets

A contingent asset arises where an event has taken place that gives the company a possible asset whose existence will only be confirmed by the occurrence of uncertain future events which are not wholly within the control of the company.

Contingent assets are disclosed under IAS 37 where it is probable that there will be an inflow of economic benefits.

The company seeks to dispose of property surplus to requirement promptly at the best price reasonably obtainable in the market. Sometimes there is uncertainty over potential use of the property and planning permissions, and in these cases the company may decide to sell the property at the underlying land value.

In these circumstances, the company will incorporate a ‘claw back’ clause into the terms of the sale, under which it is able to reclaim a percentage of any increase in value arising from a grant of planning permission, for a given term after the sale has been agreed.

As it is not known for some years after the initial disposal whether any further income will arise, the company has an unquantified contingent asset relating to future values.

14 Third party assets

Third party assets exist where the company undertakes work which is funded by another party, such as a developer, where the development may have an impact on the SRN. Under Section 278 of the Highways Act 1980, the company receives payment in advance of works. The amounts received are paid into interest-bearing escrow accounts. Monies are drawn down from the escrow accounts by the company as work progresses.

These bank accounts are not company assets and therefore are not included in the company’s SoFP.

	31 March 2020 £000	31 March 2019 £000
Lloyds Bank escrow accounts	4,212	748
	4,212	748

15 Commitments

	31 March 2020 £000	31 March 2019 £000
Contracted capital commitments not otherwise included in these accounts:		
Property, plant and equipment	3,739,524	2,706,839

The company’s capital commitments as at 31 March 2020 include the following significant project commitments:

- £448.7 million relating to the M4 junctions 3 to 12, upgrading the M4 to a smart motorway between junction 3 (Uxbridge) and junction 12 (west of Reading), linking Reading and Heathrow
- £380.3 million relating to M62 junctions 20 to 25, improving this 19-mile section of the M62 by upgrading it to an all lane running smart motorway
- £286.3 million relating to A63 Castle Street; changing Mytongate junction into a split level junction and widening the eastbound carriageway.
- £284.6 million relating to A30 Chiverton to Carland Cross; a new dual carriageway to relieve congestion
- £231.1 million relating to the improvement of the A1 north of Ellingham, by providing overtaking opportunities, junction improvements and improved crossing facilities for walkers, cyclists and horse riders
- £216.0 million relating to M42 junction 6 where a new 1.5-mile dual carriageway link road is being built
- £210.0 million relating to the improvement of the 24 mile section of the M1 between junctions 13 and 16, by upgrading it to a smart motorway
- £194.0 million relating to A1(M) junctions 6 to 8; upgrading the A1(M) to a smart motorway creating a continuous 3 lane motorway between junction 3 Hatfield and junction 9 Baldock/Letchworth
- £156.6 million relating to the upgrade of the M3 between junction 9 (Winchester/A34 interchange) and junction 14 (M27 interchange)
- £130.1 million relating to the upgrade of the M27 between junction 4 (M3 interchange) and junction 11 (Fareham), turning the hard shoulder into a permanent running lane making a dual four-lane smart motorway

16 Events after the reporting period

There have been no events since 31 March 2020 to the date the accounts were authorised for issue which would affect the understanding of these accounts.

International Accounting Standards require Highways England to disclose the date on which the accounts are authorised for issue.

The Accounting Officer has authorised these accounts to be issued on the date they were certified by the Comptroller and Auditor General.

OTHER INFORMATION

17 Related party transactions

The company is an arm’s length body of DfT which is regarded as a controlling related party. The company’s primary source of funding is through DfT, based on approved expenditure that is voted on by Parliament. The total amount of funding received from DfT for the period ended 31 March 2020 amounted to £4.5 billion (2018–19 £3.8 billion). During the year, the company had a number of other transactions with DfT, amounting to £3.0 million (2018–19 £0.8 million). In addition, the company had transactions with other government departments and agencies, in particular HM Revenue and Customs – £156.3 million (2018–19 £78 million) – and a number of local authorities.

Colin Matthews, the company’s Chairman, is also the Chairman of EDF Energy Holdings Limited since November 2017. During the year, the company had transactions with EDF Energy totalling £29.6 million (2018–19 £22.7 million).

18 Summary of significant accounting policies

This section provides additional information about the overall basis of preparation that the Directors consider to be useful and relevant to understanding these financial statements.

18.1 Basis of preparation

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union and applied in accordance with the provisions of the Companies Act 2006.

Where IFRS permits a choice of accounting policy, the accounting policy which is judged to be most appropriate to give a true and fair view has been selected. The key accounting policies adopted are described below. They have been consistently applied in dealing with items considered material to the accounts.

18.2 Measurement convention

The financial statements have been prepared on an historical cost basis, except where specific departures, including fair value, are described. Historical cost is a measure in which the value of an asset on the balance sheet is recorded at its original cost when acquired by the company. In subsequent periods, that recorded cost is not updated for any increase in prices, although it may be for falls in value. See note 10.1 on page 200.

18.3 Revenue recognition

The accounting policies for the company’s revenue streams are explained in note 2.

18.4 Grants

Grants are recognised in the accounts where there is reasonable assurance that they will be received. Grants that relate to specific capital expenditure with attached conditions are credited to deferred income in the Statement of Financial Position and are recognised in net expenditure over the assets construction period. Grants for revenue expenditure are credited to net expenditure (see note 2).

The company makes a small number of grants to public sector, private sector and voluntary bodies. These grants are recognised at the point at which the grant agreement is authorised by all related parties.

18.5 Corporation Tax

The company’s Corporation Tax policy is outlined in note 5.

18.6 VAT

Many of the activities of the company are non-business in nature and, for this reason, outside the scope of VAT. The company is eligible under section 41 (3) of the VAT Act 1992 to recover input VAT which is recovered under an annual HM Treasury Direction. Irrecoverable VAT is charged to the relevant expenditure category or included in the capitalised purchase cost of non-current assets. Where output tax is charged or input VAT is recoverable, the amounts are stated net of VAT.

18.7 Leases

The company has changed its accounting policy for leases where the company is the lessee. The policy for measurement is described in 7.5.1 and the impact of transition in note 19.1.

18.8 Research and development

Expenditure on research is not capitalised. Development expenditure that does not meet the criteria for capitalisation is also treated as an expense and shown in net expenditure in the year in which it is incurred.

18.9 Impairment of financial assets

The company assesses at each balance sheet date whether there is objective evidence that financial assets are impaired.

Under IFRS 9, we employ a forward-looking expected loss model. This means that we consider current and forward-looking information to assess whether a historic event or the potential for a future event has an impact on estimated future cash flows.

Financial assets are grouped based on similar risk characteristics, taking into account asset type, industry, geographical location, collateral type, overdue status and other relevant factors. These characteristics are relevant to the estimation of future cash flows as they are indicative of the counterparty’s ability to pay all amounts due according to the terms of the contract.

The future cash flows relating to loans and receivables are used to evaluate any impairment of the assets. The amount of impairment loss is the difference between the asset’s carrying amount and the present value of estimated future cash flows.

The methodology and assumptions used for estimating future cash flows are reviewed regularly to minimise differences arising between loss estimates and actual losses incurred.

18.10 Cash

Cash comprises bank balances held with the government banking service and commercial bank accounts.

18.11 Receivables

Trade receivables and accrued income are classified as financial assets held at amortised cost in accordance with IFRS 9.

Receivables are recognised initially at fair value, plus transactional costs. Fair value is usually the contractual value of the transaction. Thereafter, receivables are held at amortised cost. See note 7.2 for further information about the accounting for trade receivables and note 18.9 for a description of the company’s impairment policies.

18.12 Non-current Assets

For full details of the accounting policies governing non-current assets being property plant and equipment, intangible assets, assets held for sale and inventory, together with full details of their application, see note 6.

18.13 Financial liabilities

Financial liabilities are any contractual obligations to deliver cash or other financial assets to a third party including trade and other payables (current and non-current).

The company values liabilities initially at fair value: the transaction value is considered to be the fair value at the date of recognition. Thereafter, where the time value of money is considered to be material, they are held at amortised cost using the effective interest rate to discount cash flows.

Derecognition (i.e. removal from the financial statements) occurs when the liability has been settled. For more information on trade and other payables see note 7.3.

18.14 Provisions

Provisions are recognised when the company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and the amount can be reliably estimated. The measurement of the provision is based upon the best estimate of the expenditure required to settle the obligation.

Provisions are charged to the Statement of Comprehensive Net Expenditure unless they relate to capital projects. In which case, the provision is added to the assets carrying amount. Provisions are discounted where the effect is material. For more information about the provisions that we hold, see note 7.4.

18.15 Contingent liabilities

Contingent liabilities are disclosed under IAS 37 in note 12.

The company discloses as contingent liabilities:

- Potential future obligations arising as a result of past obligating events, where the existence of such an obligation remains uncertain pending the outcome of future events outside of the company’s control.
- Present obligations arising from past events that are not recognised because it is not probable that an outflow of resources will be required to settle the obligation or the amount of the obligation cannot be measured with sufficient reliability.

Where the time value of money is material, contingent liabilities are stated at discounted amounts.

18.16 Contingent assets

A contingent asset arises where an event has taken place that gives the company a possible asset whose existence will only be confirmed by the occurrence of uncertain future events which are not wholly within the control of the company.

Contingent assets are not recognised in the Statement of Financial Position but are disclosed under IAS 37, in note 13, where there will be a probable inflow of economic benefits.

18.17 Service concessions – PFI contracts

Service concession contracts, otherwise known as PFI contracts, are accounted for in accordance with IFRIC 12. The related policies are disclosed in note 7.5.

18.18 Employee benefits

Policies surrounding staff costs, including performance-related bonuses, holiday pay, termination costs and pensions, are disclosed in note 3.1.

18.19 Reserves

For full details of equity and reserves see note 8.

19 New and amended standards

The company has reviewed all new accounting standards, amendments and interpretations of standards that are effective during the year ending 31 March 2020 to determine the impact, if any, on the financial statements.

IFRS 16

IFRS 16 establishes revised principles for the recognition, measurement, presentation and disclosure of leases in the financial statements. The objective is to ensure that lessees and lessors provide relevant information that faithfully represents those transactions. IFRS 16 requires lessees to account for all leases on their balance sheets (as a right-of-use asset and a commensurate liability to pay for it), including those which were previously treated as operating leases under the previous leasing standard (IAS 17) and accounted for in the Statement of Comprehensive Net Expenditure as an in-year expense. This aligns the treatment of all leases in the financial statements of lessees (subject to transitional arrangements, as discussed below), in a way that is similar to the accounting for finance leases under the previous standard.

For its first-time application of the standard, the company has used the cumulative catch-up approach, under which the cumulative effect of initial application is recognised in the current year. As a result, on transition the company recognised £59.8 million of right-of-use assets (in addition to those already accounted for under a similar model in the previous standard) and £64.2 million of additional lease liabilities. The difference between the value of the lease liabilities and assets is due to rent free periods which have been treated as depreciation of the asset at recognition as allowable within the standard. There has been no adjustment to retained earnings. Costs are taken to net expenditure through the depreciation of right-of-use assets and interest is charged on the lease liability. This has led to a different expenditure profile compared to the ‘straight line’ cost profile used for operating leases in IAS 17. Comparatives have not been restated.

A key change introduced by the new standard is the concept of embedded leases. IFRS 16 requires us to consider whether our contracts contain lease elements which should be separated out from the host contract and brought on balance sheet; for example, managed service agreements for telecommunications and multi-functional devices often contain embedded leases. We have developed a systematic review process to assist the business in identifying any embedded leases which may lead to an increase in lease balances in the future. We have not identified any embedded leases as part of this process, however, we have identified peppercorn rents as leases due to a difference in reporting of IAS 17 to IFRS 16.

On transition, the company, as allowed by the standard, elected to restrict the application of IFRS 16 to contracts that were previously identified as leases under IAS 17. Contracts not identified as leases under IAS 17 were not reassessed to determine whether there is an embedded lease. The definition of a lease under IFRS 16 was therefore applied only to contracts entered or changed on or after 1 April 2019. For the related disclosure see note 7.5.1. There have been some adjustments to existing leases, however, this is driven by amendments to lease end dates and not through reassessment.

Upon first time adoption, IFRS 16 requires that the company disclose a reconciliation between closing operating lease commitments (under IAS 17) at 31 March 2019 and opening lease liabilities (under IFRS 16) at 1 April 2019. This is laid out below:

	£000
Operating lease commitments disclosed as at 31 March 2019	76,270
Recognition and adjustments to existing leases	6,765
Impact of discounting	(6,139)
Derecognition of irrecoverable VAT	(12,746)
Lease liability recognised as at 1 April 2019	64,150

20 Standards not yet adopted

IFRS 17 insurance contracts is on the horizon but is not due to come into effect until at least January 2021. It requires a discounted cash flow approach to accounting for insurance contracts. Highways England currently has no contracts which meet the definition of insurance contracts, so the standard is not expected to have any impact upon the company’s financial statements.

21 Changes in accounting policy

The following changes to accounting policy have impacted upon the company’s financial statements in this financial year:

1) Leases

Refer to note 19 (new and amended accounting standards) for information on the transition and impact of the implementation of IFRS 16.

2) Contingent Liabilities

During the year the company has changed its policy with regards to the disclosure of contingent liabilities relating to land and property acquisitions.

The construction of any major road scheme invariably requires the acquisition of property. The Highways Act 1980 gives the Secretary of State the power to make compulsory purchases. Possible purchases for schemes in the major projects programme were previously included as contingent liabilities until the point that a CPO/DCO announcement was made and a reliable estimate was available. Following a review of this policy, we do not consider that there is a constructive or legal obligation prior to CPO/DCO due to the potential for projects to be delayed or cancelled and as such we no longer recognise a contingent liability.

In addition, road schemes, when announced, can adversely impact surrounding property values and The Town and Country Planning Act 1990 provides for individuals to claim compensation for the blight of their properties. Possible blight costs for schemes in the major projects programme were previously included as contingent liabilities until the point that a preferred route is announced. Following review, we do not consider that there is a past event leading to an obligation prior to preferred route announcement and potential blight contingent liabilities are no longer disclosed.

Home owners can apply for compensation for lost value under Part 1 of The Land Compensation Act 1973, where property, which was not acquired for a road scheme, has lost value because of physical factors, including noise, light, dirt, smell and vibration associated with the new or improved roads. Claims become inevitable once the construction phase is started and the company accounts for the constructive obligation as a provision. A legal obligation crystallises one year after the road has opened for traffic when homeowners are entitled to lodge claims that are normally settled in less than a year. We no longer consider there to be a constructive or legal obligation in relation to Part 1 claims prior to start of works, due the potential for scope change, delay or scheme cancellation, and therefore are not disclosing any contingent liabilities in relation to Part 1 claims.

HOW THIS TIES TO OUR FUNDING

22 Financial Reporting Manual (FReM) disclosures

As a publicly-owned body, the company obtains funding through the government estimates process and our financial performance feeds into the whole government accounts (WGA).

There are some discrepancies between the accounting treatment for financial accounting purposes (under IFRS) and for budgetary purposes (under FReM) which mean that we are required to reconcile our financial statement results to the WGA budgetary totals.

As a result of the implementation of HM Treasury’s alignment project in 2011–12, most differences between the financial accounts and budgets have now been removed. The majority of transactions should therefore be recorded in budgets at the same value and with the same timing as recorded within the financial accounts. There are however some outstanding misalignments. Those relevant to the company are set out below:

Capital income: Income that counts as capital transfers in the national accounts, such as third party payments to finance the construction of an asset, passes through capital budgets. This income remains in the SoCNE for financial accounting purposes.

Research and development (R&D): R&D expenditure that meets the criteria under the National Accounts is recorded as capital in budgets. This differs to the treatment in the financial accounts where research expenditure is usually expensed in the SoCNE.

In order to reflect the inconsistencies in accounting treatment we produce a segmental report, see note 22.1, which provides a visual reconciliation between our financial position from a budgeting (FReM) perspective to our statutory financial statements.

In the interests of ensuring that our annual report is aligned to the requirements of our stakeholders, much of the financial review (see page 12) aligns to our funding allowance and not directly to the financial statements.

22.1 Segmental report

The segmental report shown below provides a reconciliation between our financial position from a funding perspective to our statutory financial statements.

	Year to 31 March 2020					
	Resource expenditure £000	Resource income £000	Resource total £000	Capital expenditure £000	Capital income £000	Capital total £000
Total by segment						
Asset renewals	–	–	–	720,846	–	720,846
Asset improvements	–	–	–	2,199,471	(28,220)	2,171,251
Traffic management	–	–	–	12,914	–	12,914
Other	–	–	–	325,265	–	325,265
Maintenance (B3)	274,509	(7,433)	267,076	–	–	–
Renewals (B4)	12,648	–	12,648	–	–	–
Operate: Roads PFI (B5)	523,915	–	523,915	–	–	–
Operate: General (B1)	132,277	(10,343)	121,934	–	–	–
Operate: Cust Ops/Traffic Man (B2)	100,954	(5,881)	95,073	–	–	–
Support General (C1)	205,685	(7,547)	198,138	–	–	–
Protocols (D)	66,768	(473)	66,295	–	–	–
	1,316,756	(31,677)	1,285,079	3,258,496	(28,220)	3,230,276
Unallocated costs:						
Depreciation & impairment	1,201,487	–	1,201,487	–	–	–
Resource utilisation	(70,168)	–	(70,168)	–	–	–
New provisions (Resource AME)	26,785	–	26,785	–	–	–
New provisions (Capital AME)	–	–	–	(8,983)	–	(8,983)
Other	44,569	–	44,569	2,174	–	2,174
(FReM) Total	2,519,429	(31,677)	2,487,752	3,251,687	(28,220)	3,223,467
Budget to accounts reconciliation						
Capital income in resource transfer	–	(28,220)	(28,220)	–	28,220	28,220
R&D capital transfer	8,708	–	8,708	(8,708)	–	(8,708)
Other (inc. IFRS16 lease transfer upon adoption)	–	–	–	73,144	–	73,144
Segmental total per accounts	2,528,137	(59,897)	2,468,240	3,316,123	–	3,316,123

	Year to 31 March 2019					
	Resource expenditure £000	Resource income £000	Resource total £000	Capital expenditure £000	Capital income £000	Capital total £000
Total by segment						
Asset renewals	–	–	–	629,163	–	629,163
Asset improvements	–	–	–	1,748,274	(35,416)	1,712,858
Traffic management	–	–	–	44,870	–	44,870
Other	–	–	–	263,360	–	263,360
Maintenance (B3)	287,431	(9,586)	277,845	–	–	–
Renewals (B4)	10,746	–	10,746	–	–	–
Operate: Roads PFI (B5)	384,385	–	384,385	–	–	–
Operate: General (B1)	99,754	(18,345)	81,409	–	–	–
Operate: Cust Ops/Traffic Man (B2)	116,512	(5,764)	110,748	–	–	–
Support General (C1)	174,722	(6,754)	167,968	–	–	–
Protocols (D)	68,393	(978)	67,415	–	–	–
IFRS 16 adjustments	–	–	–	–	–	–
	1,141,943	(41,427)	1,100,516	2,685,667	(35,416)	2,650,251
Unallocated Costs:						
Depreciation & impairment	1,212,883	–	1,212,883	–	–	–
Resource utilisation	–	(3,793)	(3,793)	–	–	–
New provisions (Resource AME)	45,813	–	45,813	–	–	–
New provisions (Capital AME)	–	–	–	132,980	–	132,980
Other	50,445	–	50,445	239	8,162	8,401
(FReM) Total	2,451,084	(45,220)	2,405,864	2,818,886	(27,254)	2,791,632
Budget to accounts reconciliation						
Capital income in resource transfer	–	(27,254)	(27,254)	–	27,254	27,254
R&D capital transfer	11,117	–	11,117	(11,117)	–	(11,117)
Segmental total per accounts	2,462,201	(72,474)	2,389,727	2,807,769	–	2,807,769

- Notes:
- Operating segments are business activities that are regularly reviewed by the company's Board and senior management for decision making purposes.
 - Expenditure in the financial statements is split between capital and resource expenditure.
 - Asset renewals are a programme of SRN renewals expenditure to ensure the infrastructure continues to deliver according to the service potential, including a significant resurfacing programme.
 - Asset improvements include an agreed programme of major improvements expenditure which contributes significantly to increasing capacity and removing bottlenecks.
 - Maintenance expenditure relates to lump sum duties including winter maintenance, pothole repairs, drainage clearing and grass cutting.
 - Operate expenditure includes the costs of strengthening the company's SRN management function, maximising SRN availability and reducing the impact of incidents and recurrent congestion.
 - Support expenditure includes the resources to help deliver the programme, including staff costs, IT and research and development.

Other FReM disclosures

22.2 Civil service and other compensation schemes – exit packages

Where appropriate, redundancy and other departure costs have been paid in accordance with the provisions of the Civil Service Compensation Scheme, a statutory scheme made under the Superannuation Act 1972. Exit costs are accounted for in full in the year of departure.

Where Highways England has agreed early retirements, the additional costs are met by the Company and not by the Civil Service pension scheme. Ill-health retirement costs are met by the pension scheme and are not included in the table.

	Year to 31 March 2020		Year to 31 March 2019	
	Number of compulsory redundancies	Number of other departures agreed	Number of compulsory redundancies	Number of other departures agreed
<£10,000	–	–	49	1
£10,000 – £25,000	–	3	38	1
£25,001 – £50,000	–	3	1	3
£50,001 – £100,000	–	2	–	–
£100,001 – £150,000	–	1	–	1
£150,001 – £200,000	–	–	–	–
£200,001 plus	–	–	–	–
Total number of packages	–	9	88	6
Total resource cost (£)	–	432,187	949,108	253,250

One exit package above the cabinet office threshold of £100,000 took place in the period. This package was provided with the required approvals set out within the Cabinet Office Guidance on Settlement Agreements.

22.3 Operating income

Fees and charges provided to external and public sector customers can be analysed as follows:

Disclosure under HM Treasury’s Managing public money

	Year to 31 March 2020			Year to 31 March 2019		
	Income £000	Full cost £000	Surplus/(deficit) £000	Income £000	Full cost £000	Surplus/(deficit) £000
Recoveries from third parties for damage to the SRN	6,866	6,866	–	9,002	9,002	–
Fees and charges for third party schemes	10,158	10,158	–	17,728	17,728	–
National vehicle recovery	5,857	7,187	(1,330)	5,750	6,672	(922)
Rental income from properties	3,585	4,063	(478)	3,507	4,017	(510)
Other income	30,326	30,326	–	30,241	30,241	–
	56,792	58,600	(1,808)	66,228	67,660	(1,432)

The financial objective for each of these services is full recovery of the service costs in accordance with HM Treasury’s *Managing public money*. In some instances this objective has not been achieved. In particular, full recovery for damage to the SRN has not been possible due to value for money considerations, and for national vehicle recovery full recovery is not possible due to issues around level of information available and ability to enforce repayment.

Operating income analysed by activity is as follows:

	Year to 31 March 2020 £000	Year to 31 March 2019 £000
Cost recoveries/rental income on office estate	1,505	1,650
Fees and charges to external customers	10,158	17,728
Rental income from properties	3,585	3,507
Recoveries from third parties for damage to the SRN	6,866	9,002
Interest receivable	17	7
National vehicle recovery	5,857	5,750
Other	31,688	31,091
Income totals	59,676	68,735

22.4 Losses and special payments (subject to audit)

Managing public money requires a statement showing losses and special payments by value and by type to be shown where they exceed £300,000 in total and those that, individually, exceed £300,000. Losses may relate to cash and store losses, bookkeeping losses, losses arising from a failure to make adequate charge for the use of public property or services, fruitless payments and claims abandoned as well as frauds. Special payments may relate to extra-contractual, extra-statutory and ex-gratia payments and compensation.

(a) Losses statement

	Year to 31 March 2020	Year to 31 March 2019
Total number of losses		
Constructive losses	2	2
Bookkeeping/cash losses	17	–
Claims abandoned	445	776
Store losses	79	274
Total	543	1,052

	Year to 31 March 2020 £000	Year to 31 March 2019 £000
Total value of losses		
Constructive losses	950	4,947
Bookkeeping/cash losses	78	–
Claims abandoned	2,767	8,896
Store losses	529	2,249
Total	4,324	16,092

Details of cases over £300,000

Constructive losses

These losses relate to procurement action causing the loss. This may be due to a change in policy that renders the stores or services less useful or not required at all.

There were two constructive losses in the year over £300,000. The first relating to hotel costs booked in preparation for EU exit in October (subsequently delayed). The value of the payment was £497,315. The second relates to a border readiness checks contract to provide personnel to check and permit vehicles to process towards our borders with the EU (not required under the EU transitional agreement). The value of the payment was £495,613.

Bookkeeping/cash losses

These losses relate to accounting corrections and losses not considered viable or value for money to pursue.

There are no bookkeeping or cash losses greater than £300,000.

Claims abandoned

These losses largely relate to damage to the road network and traffic management clean-up costs, where the culprit is unknown and it is not viable to pursue the claim.

There are no abandoned claims greater than £300,000.

Store losses

These losses largely relate to theft or vandalism to SRN equipment where the culprit is unknown. This includes cables, fencing, barriers, communication equipment, signs or lighting.

There are no store losses with a value greater than £300,000.

(b) Special payments

	Year to 31 March 2020	Year to 31 March 2019
Total number of special payments		
Ex-gratia payments/compensation	19	15
	Year to 31 March 2020 £000	Year to 31 March 2019 £000
Total value of special payments		
Ex-gratia payments/compensation	923	1,676

Details of cases over £300,000

There were two special payments with a value greater than £300,000. The first related to the infringing of a development consent order on the A14 Cambridge to Huntingdon scheme, where a misunderstanding over land use led to the construction of an asphalt plant on land earmarked for soil storage. The value of the payment was £320,000. The second for £300,000 related to the environmental stipulation of a project to buy land to sow crops for migratory birds.

Dart Charge losses

Highways England operates the Dartford-Thurrock River Crossing Charging Scheme on behalf of the Secretary of State. During 2018–19 an impairment loss of £44.3 million was reported; £3.8 million relating to road user charge revenue and £40.5 million relating to enforcement revenue. These amounts have been impaired on the basis of their recoverability, this is characteristic of all penalty charging regimes. Losses are disclosed in the DfT accounts and further details are provided in the 2018–19 Dartford-Thurrock River Crossing Charging Scheme Account.

22.5 Remote contingent liabilities

Under IFRS, contingent liabilities that are considered to be remote are not disclosed, however their narrative disclosure is required by the FReM.

A contingent liability is a potential liability that may occur depending on the outcome of an uncertain future event; they do not meet the criteria for a provision. These are disclosed in note 12 of the accounts.

Remote contingent liabilities occur where the possibility of future settlement is very small.

The company holds indemnities embedded within some procurement contracts. These indemnities are a promise by the company to compensate another for losses suffered as a consequence of works undertaken on the SRN. Indemnities provide security against or exemption from legal liability where asset damage, contamination or loss of income may arise.

Our most significant indemnities relate to works which impact upon statutory undertakers (SUs), for example to negate risks created by the requirement to move, or when we are working close to, a gas main or electricity infrastructure when building a new stretch of road. The approximate value of these indemnities is dependent upon the outcome of uncertain events and as such they cannot be accurately estimated. The potential to incur significant losses as the result of work impacting upon SUs is considered to be highly remote.

22.6 Highways England off-payroll appointees, consultancy and temporary staff

As part of the review of tax arrangements of public sector appointees published by the Chief Secretary to HM Treasury on 23 May 2012, departments and their arm's-length bodies have been asked to report on their off-payroll engagements and related tax arrangements for the periods and scope outlined by HM Treasury. This data is shown in the following tables:

Table 1: For all off-payroll engagements as of 31 March 2020, for more than £245 per day and that last for longer than six months

No. of existing engagements as of 31 March 2020	8
Of which:	
No. that have existed for less than one year at time of reporting	7
No. that have existed for between one and two years at time of reporting	1
No. that have existed for between two and three years at time of reporting	–
No. that have existed for between three and four years at time of reporting	–
No. that have existed for four or more years at time of reporting	–

The company confirms that all existing off-payroll engagements, outlined above, have at some point been subject to a risk-based assessment as to whether assurance is required that the individual is paying the right amount of tax and, where necessary, that further evidence has been sought.

Table 2: For all new off-payroll engagements, or those that reached six months in duration, between 1 April 2019 and 31 March 2020, for more than £245 per day and that last for longer than six months

No. of new engagements, or those that reached six months in duration, between 1 April 2019 and 31 March 2020	7
Of which:	
No. assessed as caught by IR35	7
No. assessed as not caught by IR35	–
No. engaged directly (via PSC contracted to department) and are on the departmental payroll	–
No. of engagements reassessed for consistency/assurance purposes during the year	–
No. of engagements that saw a change to IR35 status following a consistency review	–

There were a total of nine new engagements that joined Highways England between 1 April 2019 and 31 March 2020, but only seven of these will be with us longer than six months and will earn over £245 per day.

All contracts included contractual clauses giving the company and DfT the right to request assurance. All engagements were ones where DfT requested tax compliance evidence and there were no contracts where an individual was exempt from this requirement.

Table 3: For any off-payroll engagements of Board members, and/or, senior officials with significant financial responsibility, between 1 April 2019 and 31 March 2020

No. of off-payroll engagements of Board members, and/or, senior officials with significant financial responsibility, during the financial year	1
Total no. of individuals on-payroll and off-payroll that have been deemed 'Board members, and/or, senior officials with significant financial responsibility', during the financial year – this figure should include both on-payroll and off-payroll engagements	11

Details of the exceptional circumstances that led to the above off-payroll engagements and the length of time each of these engagements lasted:

At 31 March 2020, there were two Board members at Highways England (the Chief Executive and Chief Financial Officer) and 10 senior officials with significant financial responsibility.

There was one off-payroll engaged worker with significant financial control. Victoria Higgin, Chief Information Officer, started on 30/09/19 and was originally contracted to the role for six months (until 31/03/20) a position which has now been extended to 30/09/20.

During the year, the company employed a number of consultancy and temporary staff. Expenditure on consultancy and temporary staff is shown in the table below.

Table 4: Expenditure on consultancy and temporary staff

	Consultancy (£m)	Temporary Staff (£m)	Total (£m)
Highways England	2.8	3.1	5.9

Consultancy here is the provision of objective advice relating to strategy, structure, management or operations of an organisation, in pursuit of its purposes and objectives. Such advice will be provided outside the 'business-as-usual' environment when in-house skills are not available and will be time-limited. Consultancy may include the identification of options with recommendations, or assistance with (but not the delivery of) the implementation of solutions.