

FInTAG Guidance



UK Government
Investments

UK Government Investments Limited

Estimating Legal Exposure

The Financial Instruments and Transactions Advisory Group

October 2026

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Contacts

Contact us: fintag@ukgi.org.uk

Purpose and Scope

Why this guidance has been produced

Departments across government regularly report legal exposures and contingent liabilities for financial reporting, budgeting and parliamentary accountability purposes. The Financial Instrument and Transactions Advisory Group (FInTAG) reviews and analyses this information as part of its wider cross government contingent liability and financial risk monitoring activities. Through this work, FInTAG observes differences in the approaches, assumptions and methods used to estimate legal exposures.

This guidance supports a more consistent, proportionate and transparent approach across government. Greater consistency:

- Improves the quality and comparability of information available to departments, HM Treasury and other stakeholders;
- Supports more effective portfolio analysis and benchmarking; and
- Helps departments explain and evidence the basis of their estimates.

The guidance does not replace departmental judgement or legal advice. It provides a common framework that departments can adapt to the circumstances of individual cases.

Who is this guidance for?

This guidance is for UK government departments and, where relevant, other public bodies assessing legal exposure for financial reporting and contingent liability purposes. It is primarily intended for finance, reporting and governance teams responsible for preparing estimates, returns, disclosures or supporting analysis.

Legal and finance teams should work together while retaining their separate responsibilities:

- Legal advisers and Government Legal Department (GLD) advise on the legal basis, procedural position, prospects, remedies and potential costs of the case.
- Finance teams apply the relevant reporting framework and prepare the accounting and contingent liability assessment using that advice.

What does this guidance cover?

This guidance provides a practical framework for estimating legal exposure under IAS 37, as adapted by the Government Financial Reporting Manual (FrM). It explains how to:

- identify the relevant legal exposure;
- distinguish legal exposure from an accounting liability;
- determine the appropriate reporting classification;
- estimate expected loss and reasonable worst case;
- distinguish contingent exposure from annual expenditure and crystallized amounts;
- document the evidence, assumptions and uncertainties supporting each estimate;
- consider adverse costs, limits, recoveries and timing; and
- review and update estimates as a case develops.

Departments should adapt the framework proportionately to the nature, value, maturity and complexity of the use.

Status and limitations

This guidance supports a consistent and proportionate approach to estimating legal exposure. It does not create or amend accounting requirements, legal duties or disclosure obligations.

Departments must continue to apply the relevant requirements, including IAS 37, FrM, Managing Public Money, the Consolidated Budgeting Guidance and applicable court or tribunal rules.

Estimates should:

- reflect the facts and evidence available at the reporting date;
- take account of current legal, financial and specialist advice;
- be proportionate to the value, maturity and complexity of the case;
- identify the principal assumptions and uncertainties; and
- be reviewed when the case materially changes.

The framework does not constitute legal advice or litigation strategy. Departments should obtain advice from departmental lawyers or GLD where required. FInTAG does not prepare, approve or

validate departmental estimates. Responsibility for the estimate and its supporting judgement remains with the department.

Confidentiality and privilege

Departments should apply their existing arrangements for legal professional privilege, information handling and disclosure under the Freedom of Information Act 2000 and Environmental Information Regulations 2004. Legal and finance teams should agree what information is necessary to support the estimate. Finance teams should normally receive the minimum outputs required, such as the case stage, broad merits assessment, outcome range, likely remedy, adverse costs position and principal uncertainties. Finance working papers should record the basis of the accounting or valuation conclusion without reproducing detailed legal advice. Privileged material should be identified, marked and handled in accordance with departmental policy and advice from departmental lawyers or GLD.

Further advice

Legal questions should be referred to departmental legal advisers or GLD. Questions relating to contingent liability reporting under this guidance should be directed to fintag@ukgi.org.uk.

Assessing Legal Matters and Reporting Treatment

Purpose of this section

This section provides a framework for assessing legal matters for financial reporting and contingent liability purposes. It helps departments to:

- identify the full extent of legal exposure arising from litigation, legal challenge or related proceedings;
- determine whether any part of that exposure may constitute a legal liability;
- apply IAS 37, as adapted by the FReM, to determine the appropriate reporting treatment; and
- distinguish accounting treatment from wider budgetary, governance and parliamentary considerations.

Understanding legal exposure and legal liabilities

Legal exposure is the broadest assessment of the potential financial and reputational consequences of litigation, legal challenge, formal dispute, appeal or a comparable legal process. It covers the department's potential exposure before the accounting treatment has been determined.

Departments should identify material consequences arising from the proceedings and the associated legal process, including:

- damages or compensation;
- settlement payments;
- adverse costs awards;
- legal expenditure; and
- direct costs of implementing an adverse outcome.

Identifying exposure early helps the department understand the potential reporting, budgeting and contingent liability implications, even where the accounting treatment remains uncertain.

A **legal liability** is the part of the wider exposure that may give rise to a present obligation requiring assessment under the financial reporting framework. Litigation, or the prospect of

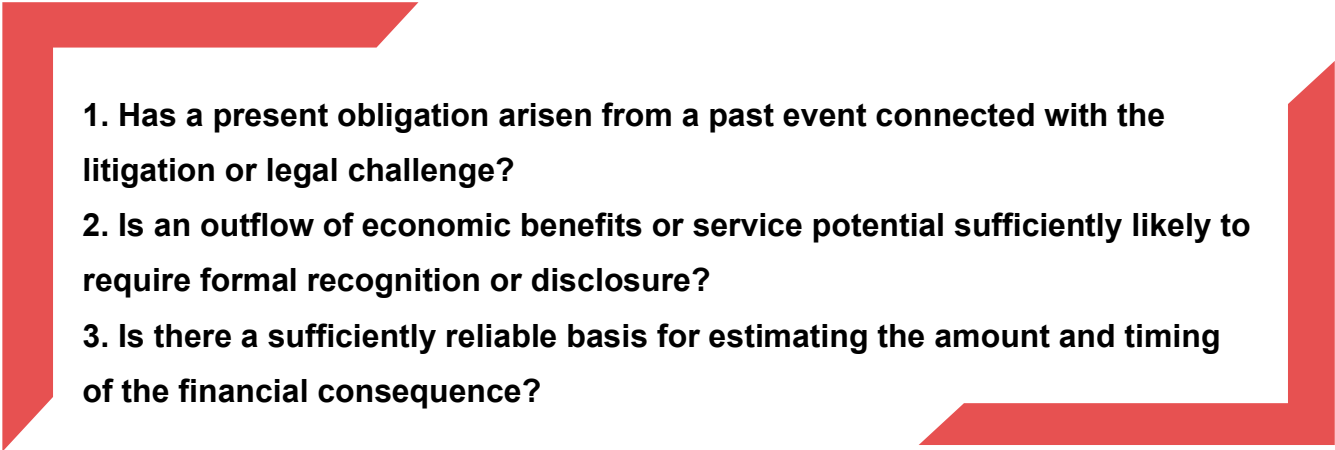
litigation, does not by itself mean that a liability must be recognised or disclosed. The department must apply IAS 37, as adapted by the FReM, to the facts existing at the reporting date.

Departments should therefore distinguish between:

- legal exposure, the broader assessment of potential adverse consequences; and
- legal liability, the narrower concept used to determine financial statement recognition or disclosure.

Determining the appropriate reporting treatment

Once legal exposure has been identified, departments should determine the appropriate reporting treatment by applying IAS 37. The assessment should involve relevant legal, finance and other subject-matter experts and address three questions:

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- 1. Has a present obligation arisen from a past event connected with the litigation or legal challenge?**
 - 2. Is an outflow of economic benefits or service potential sufficiently likely to require formal recognition or disclosure?**
 - 3. Is there a sufficiently reliable basis for estimating the amount and timing of the financial consequence?**

The assessment should determine whether the matter is:

- a provision;
- a contingent liability; or
- an internal monitoring matter.

The classification table below summarises the distinction:

Category	Basis	Stage Based Context
Provision	Where the litigation or legal challenge has created a present obligation and an outflow is probable, with a sufficiently reliable basis for estimating the financial consequence	Following a developed merits assessment, advanced settlement activity, judgment or another stage at which liability, adverse costs or remedy related expenditure has become sufficiently definite
Contingent Liability	Where the case presents a real possibility of outflow, or where a present obligation exists but the probability or measurement threshold for recognition has not yet been met	Proceedings are ongoing but merits, remedy, adverse costs, or quantum remain too uncertain for recognition
Internal Monitoring Matter	Where the legal exposure remains too early, remote or weakly evidenced to support recognition or contingent liability disclosure	Pre-action correspondence, unissued threats of claim or matters where the prospect of outflow remains remote at the reporting date

Accounting treatment should be considered separately from wider fiscal and governance implications. A matter may fall below the IAS 37 threshold while still creating significant budgetary, operational or parliamentary implications. Equally, recognising a provision does not resolve any separate spending control, approval or contingent liability management requirements.

The Stage Based Approach

Classification determines how the matter should be reported. The stage-based approach then helps the department quantify the exposure and update the estimate as the case develops.

Departments should use the approach to produce four reporting outputs:

- expected loss;
- reasonable worst case;
- annual expenditure; and
- crystallised to date.

The estimate should:

- begin with the source of the legal exposure;
- reflect the procedural stage of the case;
- reconcile probability, amount and timing;
- distinguish gross exposure from recoveries and offsets; and
- be supported by a clear record of evidence and reasoning.

Complete the steps in the following order:

0. Gather the evidence and figures.
1. Determine the current stage of proceedings.
2. Identify the relevant categories of financial consequences.
3. Define the realistic scenarios.
4. Quantify the amount associate with each outcome.
5. Derive expected loss.
6. Derive the reasonable worst-case scenario.
7. Record annual expenditure.
8. Record crystallised to date.
9. Reconcile the reporting fields and test for internal consistency.
10. Update the model at each milestone.

Step 0 – Gather the evidence and figures

Before any formal calculation is attempted, you must have a single source of truth that reflects all the papers and figures for the case (within the bounds of legal privilege), assembled in one case pack and one working table. Where legal advice is privileged, the finance team should request only the minimum outputs needed for the reporting exercise and should be closely coordinated with the legal team that handles the case. These would ordinarily include the current stage, the broad merits assessment, the likely range of outcomes, the likely remedy consequence, the likely adverse costs position, and any major uncertainties that affect quantification.

Whilst the exact evidence set will depend on the case, the following information is useful to have to hand:

Category	Primary Evidence Base	Examples of Supplementary Stage Based Context Evidence
Basic case details	• Claim form • Grounds of claim • Defense • Pre-action letters • Key orders • Current procedural notes	• Reporting date • Current stage of proceedings • Next hearing or other pertinent milestones • Likely date of resolution
Legal merits	• Internal legal advice • Counsel advice • GLD advice • Settlement advice • Any interim ruling or judgment	• Department's view of likelihood of success or loss • The realistic outcome scenarios
Claim amount and remedy	• Schedule of loss • Remedy sought • Settlement offers • Operational analysis of consequences	• Damages • Compensation • Settlement amount • Cost of retaking decision • Cost of remedial action • Cost of redress
Costs	• External legal fee estimates • Counsel fee estimates • Expert fee estimates • Adverse costs advice • Costs orders	• Claimant's likely recoverable costs • Department's own future legal spend • (If relevant) Appeal costs
Caps or Limits	• Aarhus material¹ • Cost capping orders • Statutory or contractual caps • Legal advice on whether a cap is likely	• Capped amount • Uncapped amount • The chance that the cap applies
Recoveries	• Insurance terms • Indemnities • Contractual recovery rights • Contribution rights • Enforceability advice	• Amount recoverable • Chance of award • Chance of collection • Likely timing of receipt
Timing	• Likely litigation timetable • Payment timetable • Settlement timetable	• Expected payment date and receipt date for each major item
Existing reporting position	• Prior account papers • Disclosure notes • Internal approval papers	• Current classification • Prior estimate • Movement since last review

¹ "Aarhus material" refers to documents and analysis relevant to the costs protection regime that applies in certain environmental claims under the Civil Procedure Rules. This includes whether the claim falls within the Aarhus Convention costs rules, whether any variation of the default costs caps is in issue, and what means for the department's potential adverse costs exposure.

Step 1 – Determine the current stage of proceedings

The first analytical step is to record the current procedural stage of the case. The stage of proceedings affects both the quality of evidence available and the extent to which liability and quantum can properly be assessed. For example, a judicial review at pre-action stage is usually much less certain than a judicial review that has passed permission and is moving towards a substantive hearing. Similarly, an employment claim that has only recently been presented is usually less developed than one where witness evidence has been exchanged and settlement discussions are active. Therefore, the current stage affects both the probability of loss and the reliability of figures.

Typical stage descriptions include:

- Pre-action correspondence
- Proceedings issued
- Permission pending
- Permission granted
- Substantive hearing listed
- Judgement reserved
- Judgement issued
- Settlement agreed
- Appeal under way

Step 2 – Identify the relevant categories of financial consequence

The next step is to identify the financial consequences that are directly relevant to the contingent liability estimate. For legal contingent liabilities, the relevant categories will depend on the nature of the case. In practice though, they often include damages or compensation if claimed, claimant adverse costs, settlement amounts, interest, and any other direct monetary consequence flowing from the proceedings, but do not include the department's own legal fees or other costs of defending the case. Identify each category separately. This is important because different categories may have different legal bases, ranges of uncertainty, and probabilities of arising. The estimate will be sounder and more robust if those elements are identified distinctly before they are combined.

A practical schedule might include the following:

Category of Exposure	Meaning
Principal claim	Damages, compensation, settlement sum or other direct payment to the claimant
Adverse costs	Costs the department may potentially have to pay to the other side
Settlement amount	Amount likely to be paid if the matter settles
Interest	Statutory or court awarded interest where relevant
Confirmed costs or payments	Amounts already ordered, agreed, or paid

At this stage, be careful **not** to include costs of future actions that the department may need to take in response to an adverse judgement unless there is a present obligation at the reporting date requiring recognition of those costs. The focus should remain on the direct legal exposure itself. Examples of these future categories of exposure to be omitted include:

Category of Exposure	Meaning
Own future legal spend ²	External solicitors, counsel, experts and other defence costs yet to be incurred
Remedy implementation cost	Cost of retaking a decision, rerunning a process, redress, or other direct consequence of losing
Appeal related cost	Additional cost if the case proceeds to appeal

Step 3 – Define the realistic scenarios

Create a short list of realistic outcomes. The purpose of this step is to organise the possible financial consequences into a small number of distinct and credible outcomes that can be used to derive the expected loss and reasonable worst case. In most cases, three scenarios (as given

² For the avoidance of doubt, own legal fees and other defence costs are excluded from the contingent liability estimate and are identified separately only where relevant to understanding the wider financial consequence of the case.

below) are sufficient. It is recommended not to draft more than five scenarios as it will complicate the estimation exercise without improving the accuracy meaningfully. The descriptions of the scenarios do not have to be extremely detailed, but they do have to be concretely decisive of the outcome.

Scenario	Description
S1	The department succeeds and pays little or no adverse amount
S2	The department loses in part and pays a limited amount
S3	The department loses fully and pays the full adverse amount

The descriptions should be adjusted to the actual case. In a judicial review, for example, the key difference between outcomes may be whether the department pays adverse costs only, or whether there is also some direct monetary consequence claimed in the proceedings. In a contractual dispute, the distinction may lie in the amount of damages, interest, and costs likely to be payable.

Step 4 – Quantify the amount associated with each outcome

Quantify the financial consequence associated with each realistic outcome. This means assigning an amount to each outcome, using the categories identified in Step 2 and the evidence available at the reporting date:

Outcome amount = applicable remedy amount (for example, judgement award or settlement amount) + adverse costs + interest + any other direct monetary consequence

Where the evidence supports a range rather than a single figure, you should identify a central amount for the outcome and record the range in the working paper. Estimates should be based on the best available evidence at the reporting date, which may include legal advice, expert assessments, previous settlements or judgements in comparable cases, and other relevant case-specific information. For example:

- Likely adverse costs range of £140,000 to £190,000
- Central adverse costs estimate of £165,000
- Upper adverse costs estimate of £190,000

That central amount may then be used in the expected loss calculation, while the upper amount may help inform the reasonable worst case.

Step 5 – Derive the expected loss

The expected loss is the department's central estimate of the likely financial consequence of the legal matter at the reporting date. In some cases, particularly where there is a single dominant expected outcome, the expected loss may be the amount associated with that dominant outcome. In other cases, especially where the legal and factual position gives rise to several realistic and meaningfully different outcomes, a probability weighted calculation may provide the most disciplined route to a central estimate.

The calculation should begin by defining the realistic outcomes of the case and assigning an amount to each one. We can define the set of realistic outcomes by indexing them as $s = 1, 2, 3, \dots n$. For each outcome, the department should determine two elements:

- p_s which is the probability assigned to outcome s
- L_s which is the financial loss associated with outcome s

The basic expected loss formula is therefore given as:

$$\text{Expected loss} = \sum(p_s \times L_s)$$

subject to the condition that $\sum p_s = 100\%$. This means that the probabilities assigned to all realistic outcomes must sum to 100 per cent.

For example, suppose the department identifies three realistic outcomes in a judicial review where the only direct reportable financial exposure is adverse costs.

Scenario	Description	Probability
S1	The department succeeds and pays little or no adverse amount	50%
S2	The department loses in part and pays a limited amount	30%
S3	The department loses fully and pays the full adverse amount	20%
Control Check	Sum of probabilities	100%

The expected loss is then:

$$\text{Expected Loss} = (50\% \times £0) + (30\% \times £165,000) + (20\% \times £190,000) = £87,500$$

You should then consider whether £87,500 remains a sensible central estimate in view of the legal narrative. Where legal advice is qualitative and not numerical, you should not impose artificial precision. Translate the legal assessment into a quantitative model only to the extent needed to produce a robust and explainable central estimate. Where the legal team says, for example, that the department is 'more likely than not' to succeed overall, but that a partial loss remains material, you may convert that into a small number of broad probability bands instead of highly granular percentages. The working paper should record how those assumptions were derived.

Step 6 – Derive the reasonable worst-case scenario

The reasonable worst case is a downside estimate. This field can be the most difficult estimate to produce because there is a natural tendency either to understate it by treating it as a moderate uplift on the expected loss, or to overstate it by treating it as the absolute maximum imaginable outcome. Neither approach is correct. The reasonable worst case should reflect an outcome that is unlikely but reasonably plausible based on the exposure at the reporting date as supported by the current legal and evidential position, and not a remote, purely theoretical, or worst imaginable outcome.

There are three common ways to derive the reasonable worst case.

Method A – Highest realistic scenario

Where the scenario analysis already captures the realistic downside, the reasonable worst case may simply be the amount assigned to the most adverse realistic scenario. Continuing with the example above, if Outcome 3 at £190,000 remains a realistic downside outcome, then the reasonable worst case is also £190,000. This is often the clearest method where the scenario set is well structured, and the downside scenario is already expressed as a complete outcome.

Method B - Upper end of a supported range

Where the central scenario uses a midpoint or central estimate within a range, the reasonable worst case may be the upper end of that range, provided that upper point remains realistic. For

example, if likely adverse costs are assessed in a range of £140,000 to £190,000, with a central estimate of £165,000, then the expected loss may use £165,000 and the reasonable worst case may use £190,000. This is often appropriate where the legal team is confident about the general nature of the exposure, though less certain about the precise amount.

Method C – Downside combination of components

Where several financial components are uncertain, the reasonable worst case may be built by combining the adverse but realistic value for each major component.

Suppose the department faces:

- Principal claim in the range of £300,000 to £500,000
- Adverse costs in the range £100,000 to £150,000
- Interest in the range £20,000 to £30,000

A central estimate might use the sum of the central estimate for each category: £400,000 + £125,000 + £25,000 = £550,000

A reasonable worst case might use the sum of the upper bounds for each category: £500,000 + £150,000 + £30,000 = £680,000.

You should use this method carefully and take care to not combine the worst imaginable value of each component if those values would not realistically arise together. The downside assumptions need to remain internally coherent. For example, it may be unrealistic to assume both the highest possible claim amount and the most adverse possible costs outcome if those two states are not procedurally or legally compatible. As a control check, the reasonable worst case should normally satisfy the following:

- It should be **greater than or equal to** expected loss
- It should be **less than or equal to** a purely theoretical maximum unless the maximum loss itself represents a realistic downside outcome in the circumstances of the case

Step 7 – Record annual expenditure

Annual expenditure is a factual or near factual measure of expenditure incurred in the reporting year and should therefore be drawn from actual ledger based spend and known committed

outflows rather than from the contingent liability model itself. In legal matters, annual expenditure commonly includes:

- External legal fees;
- Counsel fees;
- Expert witness fees;
- Court fees;
- Adverse costs paid in year; and
- Any other directly attributable case expenditure paid in year.

Where the return expects forecast annual expenditure rather than actual spend to date, you should separate actual incurred expenditure from forecast expenditure for the remainder of the period. A useful split is:

Annual expenditure = actual spend to date + expected spend for remainder of year

You should ensure that this field can be reconciled back to source records. For consistency, legal fees and other defence costs are included only within annual expenditure; they are excluded from expected loss and crystallised to date, which should both be measured on the same basis and reflect only amounts payable to the beneficiary or other opposing party as a consequence of the proceedings.

This ensures annual expenditure is not conflated with expected loss. A case may have very high annual expenditure and relatively low expected loss, for example where the department is spending heavily to defend a claim that it still expects to win. Equally, a case may have low annual expenditure to date and high expected loss, for example where the main financial risk lies in a future judgement or settlement as opposed to in legal spend already incurred.

Step 8 – Record crystallised to date

Crystallised to date is the amount of legal exposure that has ceased to be contingent because it has already become fixed, agreed, ordered, or paid. It should be derived by identifying the elements of the case that are no longer subject to meaningful uncertainty. You should distinguish carefully between:

- **Estimated exposure**, which remains contingent

- **Crystallised exposure**, which is already fixed in amount or legally committed

Amounts may crystallise through:

- A court order;
- An agreed settlement;
- An agreed costs order;
- A contractual or legal obligation that is no longer disputed; and
- Actual payment already made in settlement or discharge of the liability.

Crystallised to date is especially important in cases that have moved through partial settlement, split judgements, or staged costs determinations. It allows the return to distinguish between the part of the exposure that is already certain and the part that remains uncertain. A key control point is that crystallised to date should be capable of documentary support, for which you should be able to point to the relevant order, settlement agreement, payment record, or other documentary basis for the amount recorded.

Step 9 – Reconcile the reporting fields and test for internal consistency

Once you have all your figures, perform a final reconciliation and consistency check. We recommend four tests.

The first test is numerical coherence. Ordinarily the following relationships should hold:

- Reasonable worst case is **greater than or equal to** expected loss
- Annual expenditure is independent of the contingent estimate and may be either lower or higher than expected loss depending on the facts

The second test is stage consistency. The figures should match the procedural stage of the case. For example:

- At pre-action stage, a highly precise expected loss and narrow reasonable worst case may be difficult to justify.
- After permission in a judicial review, adverse costs may become the main quantified exposure and the range may narrow.

- After judgement or settlement, crystallised to date may increase materially and the residual contingent element may reduce or disappear altogether.

The third test is narrative consistency. The qualitative description in the return should reconcile with the numbers. If the narrative says that the case remains highly uncertain and legally contested, then a very narrow range between expected loss and reasonable worst case may need further justification. If the narrative says that the case is largely resolved, then a large gap between crystallised to date and the rest of the estimate may need explanation.

The fourth test is evidence sufficiency. Every key figure should be traceable to some underlying basis such as legal advice, a pleaded amount, a cost estimate, actual expenditure records etc.

Step 10 – Update the model at each milestone

To ensure accuracy as of the reporting date, we recommend you keep a record of updated figures whenever the case changes materially. A material change is any development in the case or its surrounding facts that would reasonably be expected to alter the department's assessment of probability, quantum, timing, recoverability, or classification, and therefore change the estimate itself or the basis on which it is reported.

Appendix

Appendix A: Hypothetical Worked Examples

Example Case Study 1: Judicial Review with Aarhus costs protection

A government department granted development consent for works affecting a flood defence corridor and an adjoining habitat area. A local environmental group and two individual residents brought a judicial review challenging the lawfulness of the decision. The claim alleged that the department had failed to take proper account of the environmental effects of the scheme, had misapplied the relevant statutory duties, and had given legally inadequate reasons for concluding the residual environmental impacts were acceptable. The claimants sought a quashing order in relation to the decision, a declaration as to the lawfulness of the environmental assessment process, and their costs. No damages were claimed.

The proceedings had progressed materially by the reporting date. Permission had been granted on two environmental grounds, one further ground had been refused, and the substantive hearing had been listed for a two-day hearing approximately three months after year end. The legal team advised that the department retained arguable merits and that success remained realistic, though the litigation risk was no longer low because the permission indicated that the court considered the principal grounds properly arguable. The legal team further advised that the claim was being advanced as an Aarhus Convention claim, with the consequence that the department's exposure to the claimants' recoverable costs was expected to be subject to the relevant costs protection regime unless varied by the court. The department had no current basis for concluding that the Aarhus cap would be displaced, though legal advisers considered there to be a limited possibility of challenge to the claimants' costs protection position.

The finance team had the following information at the reporting date:

- External legal fees incurred in the year to date were £128,000 and counsel fees incurred were £34,000. A further £72,000 of external legal spend and £21,000 of counsel fees were expected before the end of the proceedings if the matter ran to judgement.
- The claimants' costs schedule, on an uncapped basis, suggested total recoverable costs could exceed £180,000, though legal advisers considered that if the Aarhus costs protection applied in the ordinary way, the department's adverse costs exposure was likely to be limited to £35,000.

- Legal advisers also advised that there was a smaller but real possibility that the department might face some exposure above that amount if the costs protection were successfully challenged or adjusted, though they considered that a full uncapped costs outcome was unlikely on the current facts.
- No sums had yet crystallised through order, settlement, or payment.

Worked Calculation - Example 1

1. Identify the current stage of the case

At the reporting date, permission has been granted on two grounds, and the substantive hearing is listed. The case is therefore live, materially developed, and capable of supporting a reasoned contingent liability estimate. For the purposes of reporting on the contingent liability, we may opt to describe it as “live judicial review proceedings, permission granted on two environmental grounds, substantive hearing listed, Aarhus costs protection asserted by claimants”.

2. Identify the direct financial exposure relevant to the contingent liability estimate

No damages are claimed. The direct reportable financial exposure is therefore adverse costs. The available evidence is:

Category of Exposure	Amount
Claimants' uncapped costs indication	More than £180,000
Likely adverse costs if Aarhus protection applies in the ordinary way	£35,000
Higher supported downside amount if costs protection is varied or challenged successfully	£75,000

3. Define the realistic outcomes

The department identifies three realistic outcomes:

Outcome	Description	Probability	Adverse costs amount
S1	Department succeeds and pays no adverse costs	50%	£0
S2	Claimants succeed and Aarhus costs protection applies in the ordinary way	35%	£35,000
S3	Claimants succeed and the department faces a higher but still supported adverse costs outcome	15%	£75,000
Control Check	Sum of probabilities	100%	

4. Calculate the expected loss

The formula is:

$$\text{Expected loss} = \sum(p_s \times L_s)$$

Substituting the values, we get:

$$\text{Expected loss} = (50\% \times £0) + (35\% \times £35,000) + (15\% \times £75,000) = £23,500$$

5. Calculate the reasonable worst case

The most adverse realistic downside supported by the current evidence is the higher adverse costs outcome of £75,000. We choose not to use the full uncapped claimant costs figure as the reasonable worst case, because on the current evidence that would overstate the realistic downside given the operation of the Aarhus costs protection regime.

6. Record annual expenditure

Actual expenditure incurred to the reporting date³ is:

Item	Amount
External legal fees incurred	£128,000
Counsel fees incurred	£34,000
Total	£162,000

7. Record crystallised to date

No settlement has been agreed, no costs order has been made, and no payment has been made so the department therefore records £0 as the crystallised to date value.

8. Final output for Example 1

Return Field	Reported Figure	Basis
Expected loss	£23,500	Probability weighted adverse costs estimate under Aarhus scenario set
Reasonable worst case	£75,000	Higher supported adverse costs outcome
Annual expenditure	£162,000	External legal fees and counsel fees incurred to date
Crystallised to date	£0	No amount fixed by order, agreement, or payment

³ Where the return requires expected full year expenditure and the proceedings are expected to remain within the same reporting year, we could instead add forecast remaining spend. In our example though, the worked figure uses incurred to date.

Example Case Study 2: Employment tribunal pay and discrimination claim

A government department faced an employment tribunal claim brought by a group of 18 current and former employees alleging equal pay and indirect sex discrimination in relation to the operation of a specialist allowance paid within one business unit. The claimants alleged that the criteria used to determine eligibility for the allowance disproportionately disadvantaged women and that, in practice, the department had failed to justify the differential treatment. The claim sought arrears of pay, injury to feelings in respect of the discrimination claim, interest, and the claimants' legal costs to the extent recoverable within the tribunal process. A number of individual factual issues remained live, including the period over which losses should be calculated and the extent to which the department would be able to defend aspects of the discrimination allegation.

By the reporting date, the claims had been accepted by the tribunal, pleadings had closed, disclosure had largely concluded, and witness statements were due in two months. A preliminary hearing had already determined that the principal legal issues were suitable for determination together, though remedy and quantum would require individual adjustments if the claimants succeeded. Internal legal advisers considered that the department had a defensible position on part of the claim, though external counsel advised that there was a material risk of an adverse outcome on at least some of the allowance criteria. Counsel considered that full defeat across all claimants was possible though not the most likely outcome, and that a partial loss affecting a subset of claimants was more probable than either complete success or complete failure.

The finance team had the following information:

- Legal fees incurred to date in the reporting year were £96,000, including external legal support and counsel costs. If the matter proceeded to full hearing, a further £64,000 of legal spend was expected.
- The department's HR and reward teams had prepared a preliminary schedule suggesting that if claimants succeeded in full, the aggregate arrears of pay and associated compensation could be approximately £640,000 before interest.
- A more limited adverse outcome affecting only the principal allowance criterion was estimated at approximately £310,000 before interest. Interest, if awarded, was estimated in a range of £20,000 to £55,000 depending on the scope of success and the relevant period.
- No settlement had been agreed and no sum had crystallised to date.

Worked Calculation - Example 2

1. Identify the current stage of the case

At the reporting date, the matter is beyond an initial or speculative stage. Pleadings have closed, disclosure has largely completed, and the case is moving towards witness evidence and hearing. For the purposes of reporting on the contingent liability, we can describe the case as “employment tribunal group claim live, pleadings disclosed, disclosure largely complete, material risk of partial adverse outcome”.

2. Identify the direct financial exposure relevant to the contingent liability estimate

The direct financial exposure includes arrears of pay, compensation linked to the discrimination allegation, and interest. For this example, we assume that the central claim valuation includes the direct compensation consequences, with interest modelled separately. The available financial data is:

Category of Exposure	Amount
Full adverse outcome before interest	£640,000
Partial adverse outcome before interest	£310,000
Interest in partial outcome	£20,000
Interest in full adverse outcome	£55,000

The total amounts used in the model are therefore:

- Partial adverse outcome: £310,000 + £20,000 = £330,000
- Full adverse outcome: £640,000 + £55,000 = £695,000

3. Define the realistic outcomes

The department identifies three realistic outcomes:

Outcome	Description	Probability	Adverse costs amount
1	Department succeeds overall	35%	£0
2	Department loses in part on the principal allowance criterion	45%	£330,000
3	Department loses more broadly across the grouped claims	20%	£695,000
Control Check	Sum of probabilities	100%	

4. Calculate the expected loss

The formula is:

$$\text{Expected loss} = \sum(p_s \times L_s)$$

Substituting the values, we get:

$$\text{Expected loss} = (35\% \times £0) + (45\% \times £330,000) + (20\% \times £695,000) = £287,500$$

5. Calculate the reasonable worst case

The most adverse realistic outcome on the evidence is the full adverse outcome of £695,000.

6. Record annual expenditure

Actual legal and related expenditure incurred to the reporting date is:

Item	Amount
Legal fees incurred to date	£96,000

7. Record crystallised to date

No settlement has been agreed, and no tribunal award has been made so we record £0 as crystallised to date.

8. Final output for Example 2

Return Field	Reported Figure	Basis
Expected loss	£287,500	Probability weighted estimate of arrears, compensation, and interest
Reasonable worst case	£695,000	Full realistic adverse outcome including interest
Annual expenditure	£96,000	Legal fees incurred to date
Crystallised to date	£0	No amount fixed by award, agreement, or payment



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