

**BUFDG Guidance**

**Service Concessions Case Studies**

**This guidance document has been produced by BUFDG for BUFDG members to assist institutions implement FRS102 and the new SORP by providing practical interpretations and specific examples. It is for each institution to exercise its own professional judgement and take responsibility for applying FRS102 and the new SORP. This document has not been considered or approved by the SORP Board and is expected to be updated from time to time by BUFDG Financial Reporting Group.**

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**Introduction**

**Service Concessions Case Studies**

1. FRS102 includes a separate section on Service Concession Arrangements within section 34 (Specialised activities).
2. There are significant differences between the existing 2007 FE HE SORP and FRS102. The existing UK GAAP SORP is a risk and rewards based standard whereas FRS102 is a controls based standard. This can result in a different treatment: under UK GAAP assets are more likely to be off balance sheet; under FRS102 it is more likely that assets will be on institutions’ balance sheets.
3. There are three key questions set out in the FE HE SORP to determine whether an institution has a service concession arrangement and whether it should be on or off balance sheet.
   1. does the institution acts as principal in the arrangement?;
   2. does the arrangement meet the definition of a service concession?; and
   3. does the arrangement pass the control test in FRS102?.
4. If the Institution is the principal, the arrangement meets the definition of a service concession and all the control tests are passed then the scheme should be accounted for as a service concession agreement.

The Institution should account for service concession arrangements at the present value of the guaranteed minimum payment at any point in time. This will change year on year and could change as a result of additional guarantees being entered into – e.g. in the case of nomination rights.

1. To enable institutions to consider their own arrangements, below are some case studies illustrating the impact of FRS102 on a variety of arrangements. However we note that arrangements within the FE and HE sector vary widely and institutions will need to understand the terms of their individual schemes and assess these in line with the requirements of FRS102 and the FE HE SORP.

This guidance sets out a number of examples of schemes within the FE and HE sector and considers the application of the service concession section of FRS 102 and the FE HE SORP. It includes example year 1 accounting entries. Note that these examples may be simpler than actual schemes – eg lifecycle costs have been ignored. Institutions that conclude that their service concession arrangements are on balance sheet will need to model the accounting entries over the full life of the scheme, in line with lease accounting, in order to derive the effective interest rate. Institutions should not underestimate the detail and complexity that can be involved in some of this modelling, which will also need to kept up to date for any contract variations that take place.

Detailed guidance for accounting for service concession arrangements can be found on the Department of Health website <http://www.doh.gov.uk/doh/finman.nsf>. Whilst this guidance may be useful, institutions should note that the application within FRS 102 differs significantly to that adopted within the NHS and the public sector generally. FRS 102 requires the initial asset and corresponding financial liability to be recorded at the present value of the minimum lease payments. Within the public sector the initial asset is recognised at fair value, even where the operator receives income from third parties.

**Case Study 1 – Residency arrangement with occupancy guarantee.**

**Background**

* The project was for the design and build of student accommodation and for the refurbishment and transfer to the Special Purpose Vehicle (“SPV”) of relatively small existing University student accommodation.
* At financial completion the University granted a 40 year lease of land to the SPV (the headlease).
* Following construction/refurbishment the third party entity that builds and maintains the asset (“the operator”) retained responsibility for hard facilities management (i.e. maintenance) throughout the length of the contract
* The University retains responsibility for soft facilities management such as cleaning, portering, marketing and letting to a specification agreed with the contractor.
* The University has guaranteed a minimum rental payment based on a guaranteed occupancy level using notional letting periods and agreed rent levels. The occupancy level applicable to the guarantee reduces over the length of the contract from 90% in year 1 to 69% in year 40.
* Student residence agreements are between the student and the University. The University has the void risk on rooms under occupancy guarantee. Above this level it is primarily with the SPV but shared with the University through a profit sharing mechanism. For taking this risk and for administering rent collection the University charges a fee of 3% on the gross rents receivable/received.
* The assets are returned to the University for nil consideration at the end of the agreement.

**Application of SORP and FRS 102 service concession arrangements**

**1) Does the institution acts as principal in the arrangement?**

**Yes.**

The University has contracted with the private sector SPV. The occupancy guarantee contracted directly with the SPV supports the fact that the University acts as principal in this relationship.

In addition the University contracts directly with the students and, despite receiving a management fee for this, retains the risks associated with void and bad debts. Therefore the University also acts as principal for the rent agreement with the students.

**2) Does the arrangement meet the definition of a service concession?**

**Yes.**

The University (grantor) has contracted with the private sector (operator) to construct, operate and maintain infrastructure assets (student accommodation) for a specified period of time (40 years). The operator is paid for their services. The operator is contractually obliged to provide services to the public on behalf of the University.

**3) Does the arrangement pass the control test in FRS102?**

**a) Does the University control or regulate what services the operator must provide using the infrastructure assets, to whom, and at what price?**

**Yes**

**Control of services:** The University requires the SPV to provide and maintain specific student accommodation assets in accordance with a contracted service specification.

**Control of who uses the asset:** The University controls the students who use the student accommodation.

**Control of price:** The Minimum Rental Payment is calculated each year based on the number of rooms \* the applicable percentage room occupancy for the contract year (i.e. between 69% and 90%) \* the applicable letting period (42 or 51 weeks) \* the rent level calculated under the contract based on a starting rent and inflators stated in the contract.

The presence of the contractual agreement over the service specification and price mechanism and the fact that the University has full control over the students that occupy the accommodation means that the University does control the services the operator must provide and at what price.

**b) Does the grantor control, through ownership, beneficial entitlement or otherwise, any significant residual interest in the assets at the end of the term of the arrangement?**

**Yes**

The assets transfer to the University at the end of the arrangement at nil value, although the arrangement is considered to be for the whole useful life of the assets.

**Accounting for the scheme - has the institution guaranteed a minimum payment to the operator?**

**Yes**

Based on guaranteed occupancy rates, regardless of the actual income earned the SPV will receive a guaranteed minimum payment.

***Summary***

***An arrangement has to pass all the tests set out above to be a service concession arrangement. The above example passes all the tests and therefore the accounting should be considered in line with the service concession arrangement accounting requirements of the SORP.***

**Accounting treatment under 2007 SORP**

Institutions consider schemes under FRS5 application note 5, a risk and rewards based standard to conclude whether the circumstance of the individual scheme result in an on or off balance sheet treatment. In this particular example the scheme, using further detailed considerations which are not repeated here, was deemed off balance sheet as the balance of the risks and rewards were deemed to reside with the operator. This means that amounts due to the operator are treated as an expense in the year in which they are incurred.

**Accounting treatment under FRS102**

“On Balance Sheet.” The above analysis applying the controls based standard of FRS 102 and the SORP has resulted in these arrangement being assessed as a service concession and therefore on balance at the present value of the minimum lease payments (minimum occupancy guarantee)

In this example, let’s assume:

* Present value of the future minimum lease payments is £145m.
* The building has a useful life of 40 years. Straight line depreciation is used.
* The University guarantee occupancy at 90% reducing to 69% over 40 years.
* In year 1 the University receives a total student income of £10m and has 100% occupancy.
* The finance charge associated with the arrangement is 5% calculated using the effective interest method in line with FRS102. In order to derive this value the University should use the expected return that the SPV expects to receive throughout the arrangement. The effective interest rate is the rate which, when applied to the rental streams, results in the liability reducing to nil at the end of the rental guarantee period.
* In this example we have ignored the 3% management fee which would be income to the University.

**To bring the asset on balance sheet**

Dr Asset (Property, Plant and Equipment) £145m

Cr Financial Liability (£145m)

*The asset comes on balance sheet at the present value of the minimum lease payments. The discount rate used should be the one inherent in the scheme. – See (a) at the end for further details*

**To account for year one income in excess of the occupancy guarantee**:

Dr Cash £1m

Cr Income (residence income) (£1m)

Cr Cash (£1m)

Dr Expenses (payment to SPV) £1m

*To reflect the income received from students and paid over to the SPV. 90% of occupancy is guaranteed therefore £1m has been received in excess of the guaranteed amount. This can be considered as contingent rental in accordance with the leasing requirements of FRS102 and therefore only recognised when received.*

**The asset is subject to depreciation on a straight-line basis over 40 years**:

Cr Asset (property, Plant and Equipment) (£3.6m)

Dr Consolidated Income Statement - Expenditure £3.6m

*This depreciates the asset. Note that capital additions may be required where significant lifecycle costs are incurred. This assumes an asset life of 40 years.*

**To account for the £9m annual occupancy guarantee (year 1):**

Cr Income (residence income) (£9m)

Dr Cash £9m

Cr Cash (£9m)

Dr Consolidated Income Statement - Expenditure finance charge £7.25m

Dr Liability £1.75m

*The annual guarantee includes a 5% finance charge, in this case £7.25m, which is charged as expenditure through the Consolidated Income Statement. The remaining £1.75m is the capital repayment element which reduces the outstanding liability.*

**To account for the £9m annual occupancy guarantee (year 2):**

Cr Income (£9m)

Dr Cash £9m

Cr Cash (£9m)

Dr Consolidated Income Statement - Expenditure finance charge £7.16m

((145 – 1.75 year 1 capital repayment) \*5%)

Dr Liability £1.84m (9-7.17)

* + - * 1. NPV of minimum guaranteed cashflow Years 1-10 £9m

Years 11-12 £8.5m

Years 21-30 £8m

Years 31-40 £6.9m

Present value calculated at the effective interest rate of 5% = £145m.

**Case Study 2 – Residency arrangement with no occupancy guarantee**

**Background**

* This arrangement includes a combination of assets constructed by the public sector SPV and assets that had been constructed by the University a few years previous and sold to the SPV. The University’s assets were sold at a premium of £9.5m.
* The University has leased land to the operator for 40 years and leases the asset back, once constructed by the operator, for the remainder of the 40 year lease term. The land headlease and lease back cover the likely useful life of the asset. The lease back arrangement falls away should a situation of prolonged un-occupancy occur enabling the operator to use the asset as it sees fit.
* The operator is responsible for providing planned and lifecycle maintenance. The University provides soft facilities management, re-active hard facilities management and residential management via the terms of the underlease.
* The University has a minority equity interest in the SPV which is accounted for as an investment.
* Credit and void risk is retained by the University following occupation under the terms of the management agreement. The credit and void risk only applies once the university has contracted with a student to occupy the room. In practice this arises in the year when the student has signed the occupancy agreement with the university. This is completed by the year end.
* The University provides no guaranteed occupancy levels outside the annually agreed student rental arrangements.

**Application of SORP and FRS 102 service concession arrangements**

**1) Does the institution acts as principal in the arrangement?**

**Yes.**

The University has contracted with the private sector SPV. The University takes the credit and void risk with the student lettings and therefore acts as principal in the arrangement with the students.

**2) Does the arrangement meet the definition of a service concession?**

**Yes.**

The University (grantor) has contracted with the private sector (operator) to construct, operate and maintain infrastructure assets (student accommodation) for a specified period of time (30 years). The operator is paid for their services. The operator is contractually obliged to provide services to the public on behalf of the University.

**3) Does the arrangement pass the control test in FRS102?**

**a) Does the University control or regulate what services the operator must provide using the infrastructure assets, to whom, and at what price?**

**Yes.**

**Control of services:** The University requires the SPV to provide and maintain specific student accommodation assets.

**Control of who uses the asset:** The university controls the students who use the student accommodation by having the option to nominate up to 100% of the rooms in a given year.

**Control of price:** The contract with the operator includes a number of conditions in relation to the rent to be set.

The presence of the contractual agreement over the service specification and price mechanism and the fact that the University has full control over the students that occupy the accommodation means that the University does control the services the operator must provide and at what price.

**b) Does the grantor control, through ownership, beneficial entitlement or otherwise, any significant residual interest in the assets at the end of the term of the arrangement?**

**Yes**

The headlease and underlease are for the majority of the life of the asset. At the end of the term the headlease and therefore the asset revert back to the University.

**Accounting for the scheme - Has the institution guaranteed a minimum payment to the operator?**

**Possible, but unlikely**

The university has a guarantee once it has contracted with the individual student. If at the balance sheet date the University does have a guarantee relating to the associated minimum rental. However in practice this takes place within a financial year.

***Summary***

***An arrangement has to pass all the tests set out above to be a service concession arrangement. The above example passes tests 1 to 3 but does not have a minimum guaranteed lease payment and is therefore not considered a service concession arrangement.***

**Accounting treatment under 2007 SORP**

“Off Balance Sheet” Analysis under FRS5 application note 5, a risk and rewards based standard resulted in the scheme being off balance sheet as the balance of the risks and rewards were deemed to reside with the operator. This means that amounts due to the operator are treated as an expense in the year in which they are incurred.

**Accounting treatment under FRS102**

The present value of the minimum lease payments is nil and there is no asset and corresponding liability to be recorded. Application of the lease accounting requirements will also result in no asset or liability on balance sheet since the present value of the minimum lease payments is nil.

No balance sheet entries are required as the arrangement is off balance sheet. The SORP requires disclosure of the nature of the service concession arrangement even though there are no “on balance sheet” accounting requirements.

For this example, lets assume:

* In year 1 the University receives £15.45m in rental income (including the management fee)
* The management fee receivable by the University is 3%, £0.45m.

Annual entries in the University’s accounts would be:

**To account for the student rents collected**:

Dr Cash £15.45m

Cr Accommodation Income (£15m)

Cr Management Fee Income (£0.45m)

**To account for the rent transferred to SPV**:

Dr Accommodation Expenses £15m

Cr Cash (£15m)

Since the University retains the management fee income through the contract with the SPV it should NOT gross up the income and expenditure (e.g. residence income £15.45m, expense to SPV £15.45m, income from SPV for management fee £0.45m, management services expense £0.45m).

**Case Study 3 – Residency arrangement with University holding an operating lease with a jointly controlled entity in which the University holds a 50% interest.**

**Background**

* The University holds a 50% share in a jointly controlled entity.
* The University constructed a new accommodation block and sold this to the jointly controlled entity after 1 year. The joint venture constructed a second accommodation block.
* Hard and lifecycle maintenance is provided via a contract between a 3rd party contractor and the joint venture. The University provides soft facilities management for one building and a 3rd party contractor provides it for the other building. Residential management is via the terms of a management agreement.
* Residence agreements are between the student and the University. The University retains credit and void risk following occupation under the terms of the management agreement.
* The University has guaranteed to provide the jointly controlled entity with 80% of the net income for the first 25 years of operation.
* The headlease is for 125 years and there is no underlease.

**Application of SORP and FRS 102 service concession arrangements**

**1) Does the institution acts as principal in the arrangement?**

**Yes.**

The University has contracted with the private sector SPV. The University takes the credit and void risk with the student lettings and therefore acts as principal in the arrangement with the students.

**2) Does the arrangement meet the definition of a service concession?**

**Yes.**

The University (grantor) has contracted with the private sector (operator) to construct, operate and maintain infrastructure assets (student accommodation) for a specified period of time (25 years). The operator is paid for their services. The operator is contractually obliged to provide services to the public on behalf of the University

**3) Does the arrangement pass the control test in FRS102?**

**a) Does the University control or regulate what services the operator must provide using the infrastructure assets, to whom, and at what price?**

**Yes.**

**Control of services:** The University requires the SPV to provide and maintain specific student accommodation assets.

**Control of who uses the asset:** The university controls the students who use the student accommodation by having the occupancy guarantee and contracting directly with the students who will use the asset.

**Control of price:** The contract with the operator includes a number of conditions in relation to the rent to be set.

The presence of the contractual agreement over the service specification and price mechanism and the fact that the University has full control over the students that occupy the accommodation means that the University does control the services the operator must provide and at what price.

**b) Does the grantor control, through ownership, beneficial entitlement or otherwise, any significant residual interest in the assets at the end of the term of the arrangement?**

**No**

The headlease is for 125 years and the guarantee length is only 25 years, which is not a significant proportion of the asset’s useful life. There is considerable value remaining in the asset once the guarantee period ends which the University has no controlling interest in. Therefore this arrangement is not a service concession arrangement. The guarantee of 25 years should be assessed in accordance with the leasing standard to understand whether this is a finance or operating lease. We understand that in this example the arrangement has been assessed as an operating lease.

The University’s interest in the joint venture should be equity accounted for within the consolidated financial statements. This will result in the University’s share of net assets and operating lease into the statement of financial position and statement of income and expenditure respectively.

**Accounting for the scheme - Has the institution guaranteed a minimum payment to the operator?**

**Yes** – there is a guaranteed level of occupancy with a guaranteed share of net income.

***Summary***

***An arrangement has to pass all the tests set out above to be a service concession arrangement. The above example fails test 3b on the control of the residual interest and therefore this arrangement is not within the scope of service concession arrangements.***

**Accounting treatment under 2007 SORP**

“Off Balance Sheet” Analysis under FRS5 application note 5, a risk and rewards based standard resulted in the scheme being off balance sheet as the balance of the risks and rewards were deemed to reside with the operator. This means that amounts due to the operator are treated as an expense in the year in which they are incurred.

The Jointly Controlled Entity would be consolidated using the gross equity method under which the turnover and share of results and share of net assets are included within the consolidated Statement of Comprehensive Income and Balance sheet respectively.

**Accounting treatment under FRS102**

This arrangement is not a service concession arrangement. It is likely that the occupancy guarantee is a lease or an embedded lease which should be considered on a risk and rewards basis in line with the lease accounting requirements. It is anticipated that this will result in the same treatment as that currently adopted under the current UK GAAP risks and rewards based standards.

The Jointly Controlled Entity would be consolidated using the equity method under which the share of results and share of net assets are included within the consolidated Statement of Comprehensive Income and Balance sheet respectively. **Case Study 4 – Residency arrangement with nominations right, but no occupancy guarantee**

**Background**

* This arrangement involved the transfer of existing accommodation to the SPV and the building of new accommodation by the SPV.
* All services are provided by the operator with the exception of room booking.
* The University collects rental income from the students and has the debt and void risk on these rent receipts. The University receives a management fee of 3% for managing the residency arrangements.
* The University has the right to nominate occupancy in a single year, but do not guarantee occupation.
* The headlease and underlease run for a concession period of 40 years. At the end of the term the asset transfers to the University at nil residual value being the end of the asset life.

**Application of SORP and FRS 102 service concession arrangements**

**1) Does the institution acts as principal in the arrangement?**

**Yes.**

The University has contracted with the private sector SPV. The University takes the credit and void risk with the student lettings and therefore acts as principal in the arrangement with the students.

**2) Does the arrangement meet the definition of a service concession?**

**Yes.**

The University (grantor) has contracted with the private sector (operator) to construct, operate and maintain infrastructure assets (student accommodation) for a specified period of time (40 years). The operator is paid for their services. The operator is contractually obliged to provide services to the public on behalf of the University

**3) Does the arrangement pass the control test in FRS102?**

**a) Does the University control or regulate what services the operator must provide using the infrastructure assets, to whom, and at what price?**

**Yes.**

**Control of services:** The University requires the SPV to provide and maintain specific student accommodation assets.

**Control of who uses the asset:** The University controls the students who use the student accommodation by having the occupancy guarantee and contracting directly with the students who will use the asset.

**Control of price:** The existence of the price mechanism and services requirement within the contractual arrangement means that this test is passed.

The presence of the contractual agreement over the service specification and price mechanism and the fact that the University has full control over the students that occupy the accommodation means that the University does control the services the operator must provide and at what price.

**b) Does the grantor control, through ownership, beneficial entitlement or otherwise, any significant residual interest in the assets at the end of the term of the arrangement?**

**Yes**

At the end of the term the asset transfers to the University but at nil residual value.

**Accounting for the Scheme - Has the institution guaranteed a minimum payment to the operator?**

**Yes**

At the balance sheet date the institution has entered into a one year nomination agreement relating to the subsequent academic year. Therefore at the balance sheet there is a guaranteed minimum payment. As an example, if the institution had nominated to take 80% occupancy of the residence for the proceeding year which equates to rental income of £3m, the minimum guaranteed payment is £3m.

At the date that this guarantee is entered there is an asset and liability recognised on the balance sheet

Dr fixed assets £3m

Cr financial liability £3m

During the next academic year the liability is reduced as the rental payments are made to the operator and the asset is depreciated.

Dr Cash £3m (cash received from the student rental)

Cr income £3m (student rental income)

Dr Financial liability £3m

Cr cash £3m – rental payment to operator

Dr Expenditure £3m

Cr fixed assets £3m – being the depreciation of the fixed asset over the life for which it is recognised.

By the next year end the institution is likely to have entered into a further nominations agreement resulting in the above entries being repeated for the newly agreed nominations and so on.

***Summary***

***An arrangement has to pass all the tests set out above to be a service concession arrangement. The above example passes tests 1 to 3 but does not have a minimum guaranteed lease payment and is therefore not considered a service concession arrangement.***

**Accounting treatment under 2007 SORP**

“Off Balance Sheet” Analysis under FRS5 application note 5, a risk and rewards based standard resulted in the scheme being off balance sheet as the balance of the risks and rewards were deemed to reside with the operator. This means that amounts due to the operator are treated as an expense in the year in which they are incurred.

**Accounting treatment under FRS102**

The present value of the minimum lease payments is nil and there is no asset and corresponding liability to be recorded. Application of the lease accounting requirements will also result in no asset or liability on balance sheet since the present value of the minimum lease payments is nil.

No balance sheet entries are required as the arrangement is off balance sheet. The SORP requires disclosure of the nature of the service concession arrangement even though there are no “on balance sheet” accounting requirements.

**Case Study 5 – PFI arrangement for the construction and servicing of a Halls of Residence**

**Background**

* The University entered into a Public Private Partnership with a Housing Association (HA) to construct a new Halls of Residence. Two sites were leased to the HA via a 30 year lease, the HA demolished the existing Halls on the sites and constructed new Halls in their place.
* The University has a lease back from the HA for the new Halls. The University pay a monthly payment, commonly referred to as the unitary payment, for this lease. The HA is responsible for the hard facilities management services, and the University is responsible for soft facilities management services. The University is responsible for letting rooms and collecting rents, and also for all utility costs.
* The University sets the level of rents to be charged and retains the void and rent risk.
* At the end of the arrangement the assets will transfer back to the University for nil consideration.

**Application of SORP and FRS 102 service concession arrangements**

**1) Does the institution acts as principal in the arrangement?**

**Yes.**

The University has contracted directly with the Housing Association and pays a monthly unitary payment for the use of the asset.

The University enters into separate arrangements with the students under which it acts as principal.

**2) Does the arrangement meet the definition of a service concession?**

**Yes.**

The University (grantor) has contracted with the private sector (operator) to construct, operate and maintain infrastructure assets (student accommodation) for a specified period of time (30 years). The operator is paid for their services. The operator is contractually obliged to provide services to the public on behalf of the University.

**3) Does the arrangement pass the control test in FRS102?**

**a) Does the University control or regulate what services the operator must provide using the infrastructure assets, to whom, and at what price?**

**Yes.**

**Control of services:** The University requires the SPV to provide and maintain specific student accommodation assets in line with a specific service standard set out within the contract.

**Control of who uses the asset:** The University controls the students who use the student accommodation as the University has full control and occupancy relating to the use of the rooms.

**Control of price:** The existence of the price mechanism within the contractual arrangement means that this test is passed.

The presence of the contractual agreement over the service specification and price mechanism and the fact that the University has full control over the students that occupy the accommodation means that the University does control the services the operator must provide and at what price.

**b) Does the grantor control, through ownership, beneficial entitlement or otherwise, any significant residual interest in the assets at the end of the term of the arrangement?**

**Yes** – At the end of the term the Asset transfers to the University but at nil consideration.

**Accounting for the Scheme - Has the institution guaranteed a minimum payment to the operator?**

**Yes**- The agreement involves a monthly service payment to the Housing Association. The arrangement is a traditional PFI scheme.

***Summary***

***An arrangement has to pass all the tests set out above to be a service concession arrangement. The above example passes all the tests and therefore the accounting should be considered in line with the service concession arrangement accounting requirements of the SORP.***

**Accounting treatment under 2007 SORP**

Institutions consider schemes under FRS5 application note 5, a risk and rewards based standard to conclude whether the circumstance of the individual scheme result in an on or off balance sheet treatment. In this particular example the scheme, using further detailed considerations which are not repeated here, was deemed off balance sheet as the balance of the risks and rewards were deemed to reside with the operator. This means that amounts due to the operator are treated as an expense in the year in which they are incurred.

**Accounting treatment under FRS102**

On Balance Sheet

**In this example let us assume:**

* Present value of the guaranteed payments is £150m equivalent to the asset value
* Annual payments are made of £10m of which £1m relates to service payments and the remaining £9m is the capital repayment.
* Interest charge is 4.3%.(There will be one rate which when applied to the liability and taking into account the annual payments, will result in the financial liability being nil at the end of the arrangement. This should be calculated using the effective interest method).
* The term of the agreement is 30 years.
* This example ignores lifecycle cost throughout the arrangement.

**To bring the asset on balance sheet**

Dr Asset £150m

Cr Liability (£150m)

*This brings the Halls of Residence on balance sheet as an asset of the University.*

**The asset is subject to depreciation on a straight line basis over 30 years**

Cr Asset (property, Plant and Equipment) (£5.0m)

Dr Consolidated Income Statement - Expenditure £5.0m

*This depreciates the asset. Note that capital additions may be required where significant lifecycle costs are incurred. This assumes an asset life of 30 years.*

**To account for the year one annual payment**

Dr Consolidated Income Statement Service Expense £1m

Dr Liability £9m

Cr Cash (£10m)

Dr Consolidated Income Statement – Interest Expense £6.45m

Cr Liability (£6.45m)

*This accounts for the annual payment and the interest charge.*

**Appendix 1 – Extract from the SORP on Service Concessions**

Service concession arrangements – where the institution is the grantor

## Section 34 of FRS 102 deals with service concession arrangements. Institutions must account for arrangements as set out below if:

1. an institution acts as principal in the arrangement;
2. an arrangement meets the definition of a service concession arrangement; and
3. the arrangement passes the control tests set out in FRS 102.

## A decisions tree to assist with the identification of service concession arrangements is set out at the end of this section.

###### a) Is the institution acting as principal within the arrangement?

## Institutions should consider whether such arrangements result in an agent or principal arrangement. Where the institution is responsible for an annual unitary payment, such as within a private finance initiative, the institution will be the principal.

## Residence arrangements where the institution takes the student debt and void risk, on each student rental agreement, will result in the institution acting as a principal rather than as an agent and therefore recognising revenue received from the students gross of payments to the operator. If an institution has made a guarantee through a minimum occupancy guarantee then it will be the principal in such arrangements. An arrangement under which the institution acts as agent will be outside the scope of service concession arrangements.

###### b) Does an arrangement meet the definition of a service concession arrangement?

## A service concession arrangement typically involves a third party constructing the infrastructure used to provide the public service or to upgrade it, and operate and maintain it for a specified period of time. In return the third party entity is paid for its services over the period, and during this period the arrangement is governed by a contract, clearly setting out performance standards.

## Typical features of service concessions include:

* the procuring entity, the grantor, is normally a public sector body or public benefit entity;
* the operator is constructing or upgrading infrastructure assets used to deliver services to the public;
* an infrastructure asset is provided by a third party operator;
* the operator is responsible for managing at least some of the assets and services, and is not merely an agent;
* the contract sets out initial price and the mechanism through which future prices are to be set or regulated; and
* the operator is obliged to transfer the asset to the public benefit entity at the end of the contract, in a specified condition for little or no additional consideration.

## There are a number of arrangements within the FE and HE sector which are expected to meet the definition of a service concession arrangement with the institution acting as grantor. This would include Private Finance Initiative schemes and many residence arrangements.

## Student residence arrangements are likely to provide infrastructure for public service in this context, as such assets support the delivery of education for social benefit. This is supported by the charitable status and public benefit obligations of institutions. The definition of an infrastructure asset includes but is not limited to accommodation, teaching facilities, research facilities, fixed assets for management and administration purposes and major equipment.

###### c) Does the arrangement pass the control tests as set out in FRS 102?

## The arrangement is deemed to be in scope if it passes all of the following tests of control:

* 1. The grantor must control or regulate the infrastructure services that the operator must provide with the infrastructure, to whom the operator must provide them and at what price.
  2. The grantor must control any significant residual interest, through beneficial entitlement or otherwise, in the infrastructure at the end of the term of the arrangement. Where an asset has no significant residual interest, for example because the arrangement is for substantially the life of the asset, then test “b” does not apply and instead the arrangement is within scope of test “a” alone is met.

Accounting for service concession arrangements

## If the above considerations are all met the arrangement must be accounted for, in accordance with the leasing requirements of FRS102, as follows:

## Institutions must determine whether scheme revenues are generated from third parties, for example where the institution is acting as agent to the student rental income, or by payments made by the institutions to the operator.

## Where the arrangement involves only payments by third parties the institution will have no liabilities or assets to account for relating to third party payments. Under this scenario the institution must recognise as asset and liability for any requirement to purchase the asset at the end of the arrangement or any option to do so that is reasonably certain to be exercised.

## An arrangement is accounted for as a service concession arrangement where the payment mechanism provides for the grantor to make minimum lease payments to the operator. This could be through a contracted unitary payment or a minimum occupancy guarantee or a nominations agreement.

## Arrangements that involve renewable nominations rights will have a guaranteed minimum payment liability equivalent to any outstanding nominations agreed at the balance sheet date.

###### Initial recognition

## Infrastructure should be recognised as fixed assets of the institution because it has the right to control the use of the infrastructure. A related liability should be recognised at the same time within creditors allocated between creditors greater than or less than one year.

## The infrastructure and related liability should be recognised at the point that the institution assumes the guarantee – for example when an institution nominates a number of rooms.

## Where the operator enhances infrastructure already recognised on the Balance Sheet of the institution it should recognise the present value of the minimum payments relating to the enhancements in the carrying value of the infrastructure where the relevant criteria are met.

###### Measurement

## The fixed asset should be recognised at the present value of the minimum lease payments in accordance with the principles of finance lease accounting. Where an occupancy guarantee exists on a residence arrangement the resulting value will frequently be significantly lower than the fair value of the whole asset. In this section the 'minimum lease payments' are the elements of the minimum payments which are related to the property plant and equipment which has been constructed and provided under the agreement. It will frequently require judgement to identify this element.

###### Allocation of payments to the asset, lifecycle, financing cost and services

## Subsequent to initial recognition the minimum payments under the arrangement should be allocated between:

1. service costs to reflect the service element of the arrangement;
2. lifecycle additions;
3. repayment of the financial liability; and
4. an imputed finance charge (using the effective interest method set out in paragraphs 11.15 to 11.20 of FRS 102).

## At the outset service concession contracts typically include a financial model on which these allocations can be based.

## Where an arrangement has an occupancy guarantee, the guaranteed minimum payments are allocated between the repayment of the liability, the imputed finance charge, lifecycle additions and services in accordance with the specific circumstances of the scheme.

## Additional income received from students over and above the guaranteed payments should be recorded in the Statement of Comprehensive Income in the year to which they relate as residence income received and an expense for the payment to the operator for services. This is a contingent rental payment to the operator.

###### Prepayments

## Where the service concession arrangement requires payments to be made for the asset before the infrastructure is recognised as an asset on the balance sheet these should be recognised as prepayments. On recognition of the asset and finance lease liability the prepayment can be netted from the liability as an initial payment.

###### Depreciation and impairment

## Assets recognised under the service concession arrangement rules of FRS 102 should be depreciated and impaired in the same way as all assets of the same class.

**Occupancy Guarantees**

## A number of arrangements exist which do not meet the tests of a service concession arrangement, but under which the institution has an occupancy or similar guarantee. In such circumstances an institution must consider whether a provision should be recorded or a contingent liability disclosed for future guaranteed payments that would not be met through rental income receipts.

**Disclosures**

## This SORP requires a number of disclosures to be provided in relation to service concession arrangements. These are over and above the requirements of FRS 102, but in line with other public sector entity disclosure requirements under their accounting frameworks.

## Institutions must comply with the following disclosure requirements for all service concession arrangements whether or not an asset and /or liability is recorded on the balance sheet:

1. the value of the assets held under service concession arrangements at each balance sheet date, and an analysis of the movement in these values. It may be appropriate for institutions to disclose whether an asset is held at a value other than fair value where these values are materially different;
2. the value of the liabilities resulting from the service concession arrangement at each balance sheet date, and an analysis of the movement in these values;
3. details of the future minimum payments due to be made, separated into repayments of liability, interest and service charges:
   1. within 1 year
   2. within 2-5 years; and
   3. later than 5 years
4. The following disclosures shall be provided individually for each arrangement or in aggregate for each class of arrangements:
   1. a description of the arrangement
   2. significant terms of the arrangement that may affect the amount, timing and certainty of future cash flows
   3. the nature and extent, where significant, of
      1. rights to use specified assets
      2. rights to expect provision of services
      3. obligations to acquire or build items of property, plant and equipment
      4. rights to receive specified assets at the end of the concession period
      5. renewal and termination options
      6. other rights and obligations
      7. changes in the arrangement occurring during the period