# Service Concessions Case Studies

**March 2019**

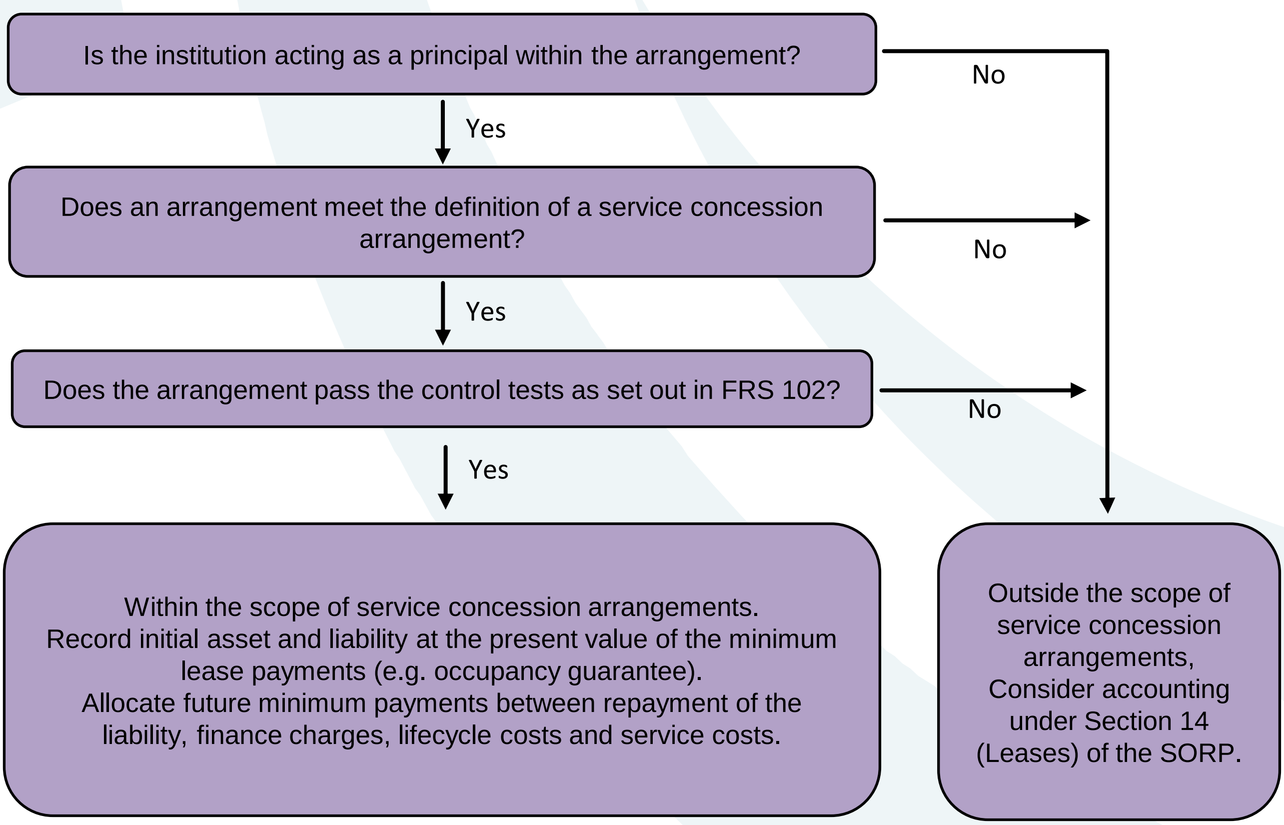
This guidance document has been produced by BUFDG for BUFDG members to assist institutions implement the requirements of FRS102 and the SORP in relation to service concession arrangements in which the Institution is determined to be the grantor by providing practical interpretations and examples. It does not contain all factors and considerations and it is for each institution to exercise its own professional judgement and take responsibility for applying FRS102 and the SORP.

This guidance does not form part of the SORP, nor does it supersede any provisions of the SORP, to which preparers of financial statements should refer. The guidance does not carry the authority of the SORP, does not represent any additional or mandatory requirement, and has not been reviewed by the Financial Reporting Council. It is for members themselves to decide how to implement the SORP and agree any changes to accounting policies with their auditors.

# Contents

# Introduction

1. FRS102 includes a separate section on Service Concession Arrangements within section 34 (Specialised activities). The relevant section in the FE HE SORP 2019 is section 26, paragraphs 26.4 to 26.30, which provides guidance and disclosure requirements beyond that set out in FRS 102.
2. This guidance sets out a number of examples of arrangements 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 arrangements – e.g. lifecycle costs (which arise from the replacement of individual components to ensure that the condition of the infrastructure asset meets the agreed standard throughout the life of the service concession arrangement) have been ignored.
3. Institutions should not underestimate the detail and complexity that can be involved in determining the nature of the arrangements in place. Arrangements will need to be kept under review for any contract variations that take place.
4. FRS 102 (paragraph 34.12) defines a service concession arrangement as *an arrangement whereby a public sector body, or a public benefit entity (the grantor) contracts with a private sector entity (the operator) to construct (or upgrade), operate and maintain infrastructure assets for a specified period of time (concession period). The operator is paid for its services over the period of the arrangement. A common feature of a service concession arrangement is the public service nature of the obligation undertaken by the operator, whereby the arrangement contractually obliges the operator to provide services to, or on behalf of, the grantor for the benefit of the public.* Paragraph 26.10 of the SORP establishes that PFI and many residency arrangements could fall within scope.).
5. There are three key questions set out in paragraph 26.4 of the SORP to determine whether an institution has a service concession arrangement and whether it should be included in the statement of financial position.
6. The three questions are set out in the below decision tree from the SORP:



## Agency vs principal arrangements:

6. The first step in the process of determining whether the arrangement should be recognised in the statement of financial position is to determine whether the institution is acting as a principal. This will involve considering the terms and conditions of the contractual arrangement and may include a degree of judgement.
7. Generally speaking an institution will be acting as principal when they are exposed to the associated significant risks and rewards. For example, *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 (26.7 of the SORP)*.
8. Where the arrangement involves a private finance initiative, the institution will typically be responsible for paying the operator an annual sum, often referred to as an annual unitary payment. In these circumstances the institution will be the principal (paragraph 26.6 of the SORP).
9. Many institutions with service concession arrangements and other leases for residences often provide guarantees for minimum levels of occupancy (i.e. guaranteeing a set amount of income for use of a Halls of residence for example). In these instances, the institution will also be considered to be the principal (paragraph 26.7 of the SORP).
10. Agency arrangements do not fall within the scope of service concession arrangements.

## Definition of a service concession arrangement:

11. The definition of a service concession arrangement as set out in FRS 102 is set out in paragraph 4 above. When considering this in the context of Institutions and the application of the SORP, the Institution will be the grantor, and a third party will be the operator in service concession arrangements.
12. Paragraph 26.8 of the SORP states that *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.*
13. A common example for institutions are student residencies. As they form a core part of an institution's delivery of education services they meet the definition of providing *services to, or on behalf of, the Institution for the benefit of the public* (paragraph 34.12). As set out in paragraph 26.11 of the SORP, t*his is supported by the charitable status and public benefit obligations of institutions.*
14. Whilst student residencies are one of the most common examples in the sector, other arrangements may involve research blocks or teaching facilities. The operator should be contracted to build or significantly upgrade the assets and should then be responsible for operating the asset, for which is receives payment. The considerations in determining whether an arrangement is a service concession are below.
15. Paragraph 26.9 of the SORP includes some typical features of service concessions. It is not expected that arrangements will meet all of these features, and judgement may need to be applied in more complex situations.
    a) the procuring entity, the grantor, is normally a public sector body or public benefit entity;
    b) the operator is constructing or upgrading infrastructure assets used to deliver services to the public;
    c) an infrastructure asset is provided by a third-party operator;
    d) the operator is responsible for managing at least some of the assets and services, and is not merely an agent;
    e) the contract sets out the initial price and the mechanism through which future prices are to be set or regulated; and
    f) 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.

16. In considering whether a contract meets the definition of a service concession, it is important to distinguish outsourcing arrangements, whereby the Institution is simply leasing a property for its own use in providing student accommodation. In this regard, paragraph 26.9(d) is relevant, as the operator in a service concession "is responsible for managing at least some of the assets and services, and is not merely an agent". Accordingly, for an arrangement to be a service concession rather than a property lease, the operator needs to be involved in the provision of services to the students occupying the residences.

## Passing the control tests

17. As stated in paragraph 26.12 of the SORP, an arrangement is considered to be in scope if both of the following are satisfied:
    a) The institution 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; and
    b) The institution must control any significant residual interest, through beneficial entitlement or otherwise, in the infrastructure at the end of the term of the arrangement.
18. For the arrangement to meet the first control test, the Institution must "regulate the infrastructure services that the operator must provide with the infrastructure". For example, in a PFI contract where the operator builds, maintains and operates the student accommodation, the operator needs to be involved in the provision of services to students and the rents that the operator can charge to students must be regulated or otherwise set the Institution under the terms of its contract with the operator. If the operator has discretion over the rent levels or is free to decide who can be a tenant in the accommodation, then the first control test above is not met.
19. Where infrastructure in an arrangement is controlled by the institution for substantially the life of the asset there may be no significant residual interest. In this situation, the institution is deemed to have met the second control test above.

## Accounting for arrangements

20. 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.

## Other considerations:

21. As set out in section 26.28 of the HE SORP, A number of arrangements exist that 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.
22. This could be relevant in examples 2 and 4 below. Both case studies provide instances where there the Institution may sign up to a nomination agreement for the following year (example 4) or may have guaranteed occupancy from Students who sign occupancy agreements prior to the reporting date (example 2).
23. Where this is the case it would be expected that a liability would be presented in the financial statements.

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 arrangements and assess these in line with the requirements of FRS102 and the FE HE SORP.

# Case Study 1 – Residency arrangement with occupancy guarantee

## Background and summary of contractual terms

- 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 Institution student accommodation.
- At financial completion the Institution granted a 40 year lease of land to the SPV (the head lease) and at the end of the arrangement the assets transfer back to the Institution.
- 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 operator is entitled to receive all the rental income generated by students.
- The Institution 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. Any income above this level is also paid across to the operator and is generated using the same pricing structure as for the guaranteed occupancy agreement.
- Student residence agreements are between the student and the Institution. The Institution has the void risk on rooms under the contract
- The Institution retains responsibility for soft facilities management such as cleaning, portering, marketing and letting to a specification agreed with the contractor and it administers rent collection.
- The Institution charges a fee of 3% on the gross rents receivable/received for these activities.
- The assets are returned to the Institution for nil consideration at the end of the agreement.

## Application of SORP and FRS 102 service concession arrangements

### 1) Does the institution act as principal in the arrangement?

Yes.

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

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

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

Yes.

The Institution (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 Institution.

*Alternative scenario:*

*In the above example the criteria for recognition as a service concession arrangement is met for this question as the operator is considered to be providing services to the users of the infrastructure asset (i.e. operating the asset) as opposed to just being responsible for the design, build and hard facilities management, and is receiving payment for them via receipt of **all** rental income.*

*If income above the guaranteed occupancy agreement was not paid across to the operator then the arrangements would need to be carefully considered as they may not be considered to meet the definition of a service concession arrangement and be more aligned to being an outsourced arrangement (see paragraph 16 above).*

# Case Study 1 – Residency arrangement with occupancy guarantee

*Where the arrangement doesn't meet the definition of a service concession arrangement the Institution would still need to consider whether the arrangement meets lease requirements and account for the transaction accordingly.*

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

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

Yes

- Control of services: The Institution 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 Institution 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 Institution has full control over the students that occupy the accommodation means that the Institution 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 Institution at the end of the arrangement at nil value, although the arrangement is considered to be for the whole useful life of the assets (40 years).

## Accounting for the arrangement - 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.*

# Case Study 1 – Residency arrangement with occupancy guarantee

## Accounting treatment:

The above analysis, applying the controls based standard of FRS 102 and the SORP, has resulted in this arrangement being assessed as a service concession and therefore recognised at the present value of the minimum lease payments (e.g. minimum occupancy guarantee).

In this example, let's assume:

- Present value of the future minimum lease payments is £145m. The NPV of minimum guaranteed cash flow p.a. is as follows:
    - 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.
- The building has a useful life of 40 years. Straight line depreciation is used.
- The Institution guarantee occupancy at 90% reducing to 69% over 40 years.
- In year 1 the Institution receives a total student income of £10m and has 100% occupancy. In year two occupancy above 90% is not achieved with rental income of £8m being achieved.
- 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 Institution 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 Institution.

### 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 arrangement.*

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

| | | |
|---|---|---|
| Cr Asset (Property, plant and equipment) | | (£3.6m) |
| Dr Depreciation expenditure | £3.6m | |

*The above assumes an asset life of 40 years and depreciates the asset. Note that capital additions may be required during the course of the arrangement where significant lifecycle costs are incurred.*

### To account for year one income:

| | | |
|---|---|---|
| Dr Cash | £10m | |
| Cr Income (residence income) | | (£10m) |

### To account for year one payments to the operator:

| | | |
|---|---|---|
| Dr Interest and other finance costs | £7.25m | |
| Dr Liability | £1.75m | |
| Dr Other operating expenditure (payment to SPV for excess income) | £1m | |
| Cr Cash | | (£10m) |

# Case Study 1 – Residency arrangement with occupancy guarantee

*The annual guarantee includes a 5% finance charge, in this case £7.25m (being the total cost of £145m*5%), which is charged as expenditure through the Consolidated Income Statement. The remaining £1.75m (bring the total back to the annual charge of £9m) is the capital repayment element which reduces the outstanding liability.*

*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. Contingent rents are defined in FRS 102 as the "portion of the lease payments that is not fixed in amount but is based on the future amount of a factor that changes other than with the passage of time (e.g. percentage of future sales, amount of future use, future price indices, and future market rates of interest)".*

To account for the year 2 rental income and payments to the operator:

| | | |
|---|---|---|
| Cr Income | | (£8m) |
| Dr Cash | £8m | |
| Cr Cash | | (£9m) |
| Dr Interest and other finance costs | £7.16m ((145 – 1.75 year 1 capital repayment) *5%) | |
| Dr Liability | £1.84m (9-7.1616) | |

# Case Study 2 – Residency arrangement with no occupancy guarantee

## Background and summary of contractual terms

This arrangement includes a combination of assets constructed by the public sector SPV and assets that had been constructed by the Institution a few years previous and sold to the SPV. The Institution's assets were sold at a premium of £9.5m.

The Institution has leased land to the operator for 40 years and leases the asset back (for nil consideration), once constructed by the operator, for the remainder of the 40 year lease term. The land head lease 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 Institution provides soft facilities management, re-active hard facilities management and residential management via the terms of the underlease.

The Institution has a minority equity interest in the SPV which is accounted for as an investment.

Credit and void risk is retained by the Institution following occupation under the terms of the management agreement. The credit and void risk only applies once the Institution 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 Institution. All income is passed onto the operator.

The Institution charges a fee of 3% on the gross rents receivable/received for the activities undertaken by them.

The Institution 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 act as principal in the arrangement?

Yes.

The Institution has contracted with the private sector SPV. The Institution takes the credit and void risk with the student lettings and contracts with them directly. It therefore acts as principal in the arrangement with the students.

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

Yes.

The Institution (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 contractually obliged to provide services to the public on behalf of the Institution.

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

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

Yes.

- Control of services: The Institution requires the SPV to provide and maintain specific student accommodation assets.
- Control of who uses the asset: The asset is leased back to the Institution, and they control the students who use the student accommodation by having the option to nominate up to 100% of the rooms in a given year. The lease back arrangement falls away only in a situation of prolonged un-occupancy, enabling the operator to use the asset as it sees fit.
- Control of price: The contract with the operator includes a number of conditions in relation to the rent to be set.

# Case Study 2 – Residency arrangement with no occupancy guarantee

Whilst the presence of the contractual agreement over the service specification and price mechanism means the Institution does not have absolute control, it is not passed to the operator. In addition, the fact that the Institution has full control over the students that occupy the accommodation means that the Institution 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 head lease and under lease are for the majority of the life of the asset. At the end of the term the head lease and therefore the asset revert back to the Institution.

## Accounting for the arrangement - Has the institution guaranteed a minimum payment to the operator?

Possible, but unlikely

As set out in section 26.16 of the SORP, *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.* No such arrangements exist in this scenario.

Further to this paragraph 34.12F of FRS 102 states: *The grantor shall initially recognise the infrastructure assets and associated liability in accordance with paragraphs 20.9 and 20.10. If as a result of applying paragraphs 20.9 and 20.10 the grantor has not recognised a liability to make payments to the operator, it shall not recognise the infrastructure assets.*

The Institution has a guarantee once it has contracted with the individual student. The present value of minimum lease payments is calculated at the inception of the lease and used to determine the value assets and liabilities should be recognised in the statement of financial position.

The future rentals are also essentially contingent on the basis that they are reliant on future variables such as the pricing mechanism and number of student residency agreements.

At the commencement of the lease it is expected that the guaranteed income would be nil, resulting in minimum lease payments of nil.

## *Summary*

*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

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 in on the statement of financial position since the present value of the minimum lease payments is nil.

No entries are required as the arrangement is not recognised in the statement of financial position.

For this example, let's assume:

In year 1 the Institution receives £15.45m in rental income (including the management fee)

The management fee receivable by the Institution is 3%, £0.45m.

# Case Study 2 – Residency arrangement with no occupancy guarantee

Annual entries in the Institution'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 Institution 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).

## Other matters:

Although the asset/liability is not recorded in the statement of financial position, it is a service concession arrangement and universities still need to comply with the disclosure requirements set out in paragraph 26.30 of the SORP.

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

## Background and contractual arrangements

The Institution holds a 50% share in a jointly controlled entity. The other party to the JV is a private property development company.

The Institution 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 Institution 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 Institution. The Institution is responsible for managing the credit and void risk following occupation under the terms of the management agreement.

The price of rentals is governed by the management agreement between the institution and the joint venture.

The Institution has guaranteed to provide the jointly controlled entity with 80% of the net income for the first 25 years of operation to compensate for the building of the second property and the contracting with the 3rd party contractor as set out above. The 20% net income retained is compensation from the jointly controlled entity to the institution under the management agreement.

The head lease is for 125 years and there is no underlease.

## Application of SORP and FRS 102 service concession arrangements

### 1) Does the institution act as principal in the arrangement?

No.

The Institution has contracted with the joint controlled entity. Whilst the Institution contracts directly with the students and manages the risks associated with void and bad debts they do not retain substantially all of the risks associated with this as evidenced via transfer of 80% of the net income. Therefore the Institution is deemed to be acting as an agent for the rent agreement with the students.

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

No.

The arrangements above do not result in the infrastructure assets being operated by the operator (i.e. the jointly controlled entity), with a substantial level of this being provided by the Institution. This is further evidenced by the payment of 80% of net income across to the operator.

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

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

Yes.

- Control of services: The Institution requires the jointly controlled entity to provide and maintain specific student accommodation assets.
- Control of who uses the asset: The Institution controls the students who use the student accommodation.
- Control of price: The contract with the operator includes a number of conditions in relation to the rent to be set.

Whilst the presence of the contractual agreement over the service specification and price mechanism means the Institution does not have absolute control, it is not passed to the operator. In addition, the fact that the Institution has full control over the students that occupy the accommodation means that the Institution does control the services the operator must provide and at what price.

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

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 head lease 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 Institution 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.

## Accounting for the arrangement - Has the institution guaranteed a minimum payment to the operator?

No – there is a guaranteed share of net income to be paid to the operator. This does not include a minimum payment where full occupancy is not achieved.

## *Summary*

*An arrangement has to pass all the tests set out above to be a service concession arrangement and therefore this arrangement is not within the scope of service concession arrangements.*

## 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.

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 statement of financial position respectively.

# Case Study 4 – Residency arrangement with nominations right, but no occupancy guarantee

## Background and summary of contractual terms

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 and the contract includes the pricing mechanism the operator must apply.

The Institution collects rental income from the students and pays this to the operator. The Institution retains the debt and void risk on these rent receipts.

The Institution receives a management fee of 3% for managing the residency arrangements.

The Institution has the right to nominate occupancy in a single year, but do not guarantee occupation.

The head lease and under lease run for a concession period of 40 years. At the end of the term the asset transfers to the Institution at nil residual value being the end of the asset life.

## Application of SORP and FRS 102 service concession arrangements

### 1) Does the institution act as principal in the arrangement?

Yes.

The Institution has contracted with the private sector SPV. The Institution 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 Institution (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 Institution.

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

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

Yes.

- Control of services: The Institution requires the SPV to provide and maintain specific student accommodation assets.
- Control of who uses the asset: The Institution controls the students who use the student accommodation by contracting directly with the students who will use the asset and by having the ability to nominate occupancy in a single year.
- 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 Institution has full control over the students that occupy the accommodation means that the Institution 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 Institution but at nil residual value.

# Case Study 4 – Residency arrangement with nominations right, but no occupancy guarantee

## Accounting for the Arrangement - Has the institution guaranteed a minimum payment to the operator?

No

### *Summary*

*The above example passes tests 1 to 3 but does not have a minimum guaranteed lease payment.*

## Accounting treatment under FRS102

The present value of the minimum lease payments at the commencement of the arrangement 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 in the statement of financial position since the present value of the minimum lease payments is nil. The SORP still requires disclosure of the nature of the service concession arrangement.

### Example:

At the reporting date the institution has entered into a one year nomination agreement relating to the subsequent academic year. Therefore at the reporting date there is a guaranteed minimum payment. As an example, if the institution had nominated to take 80% occupancy of the residence for the following 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 in the statement of financial position:

| | | |
|---|---|---|
| Dr Property, plant and equipment | £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 Property, plant and equipment | | £3m – being the depreciation of the asset |

over the life for which it is recognised (i.e. one year charge).

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.

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

## Background and summary of contractual terms

The Institution 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 Institution has a lease back from the HA for the new Halls. The Institution 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 Institution is responsible for soft facilities management services.

The Institution is responsible for letting rooms and collecting rents, and also for all utility costs.

The Institution 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 Institution for nil consideration.

## Application of SORP and FRS 102 service concession arrangements

### 1) Does the institution act as principal in the arrangement?

### Yes.

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

In addition, the Institution enters into separate arrangements with the students and retains the void and rent risk.

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

### Yes.

The Institution (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 Institution.

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

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

### Yes.

- Control of services: The Institution 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 Institution controls the students who use the student accommodation as the Institution 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 Institution has full control over the students that occupy the accommodation means that the Institution 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 Institution but at nil consideration.

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

## Accounting for the Arrangement - 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 contract.

### *Summary*

*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 FRS102

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 Institution.*

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

| | | |
|---|---|---|
| Cr Asset (Property, plant and equipment) | | (£5.0m) |
| Dr Depreciation 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 Service Expense | £1m | |
| Dr Liability | £9m | |
| Cr Cash | | (£10m) |
| Dr Interest Expense | £6.45m | |
| Cr Liability | | (£6.45m) |

*This accounts for the annual payment and the interest charge (£150m * 4.3%).*