

ACCOUNTING FOR PFI – example

Background

Department Yellow enters into a PFI deal for a new headquarters building with the Reader Sinclair Consortium. The consortium will design and build and then operate the HQ for a period of 30 years from the date of occupation. In addition, the consortium will provide the IT Systems for seven years, after which that part of the contract will terminate. The building will revert to Department Yellow at no cost at the end of the contract period. This is determined to be an on-balance sheet PFI deal.

The cost to Department Yellow comprises two elements: annual Unitary Payments (UP) and the transfer of properties (Barter Deal). The transfer of properties under Barter Deal results, over time, in lower service payments. Annual UPs cover capital, a finance charge, and a service payment. The Barter Deal comprises the transfer of five properties at various stages throughout the project, including two prior to occupation of the new HQ. The final transfer can be deferred by five years. If Department Yellow opts for deferral, the Department will pay compensation to the Consortium in the form of an upfront cash payment equal to the value of the property under the contract at the original transfer date. Upon vacation of the property, the Consortium will repay to Department Yellow the value of the property at that date.

The contract takes effect from 1 April YEAR0. The new HQ will be occupied from 1 April YEAR3. The schedule of Barter Deal transfers is:

Plot 1	1 April YEAR0	Land only
Plot 2	1 April YEAR1	Land only
Plot 3	1 April YEAR2	Land only
Plot 4	1 April YEAR4	Land and Buildings
Plot 5	1 April YEAR10 (with possible deferral to 1 April YEAR15)	Land and Buildings

The total value of the new HQ and IT is £250 million, of which £25 million is financed by the Barter Deal and £225 million by the capital element of the UP. It is estimated that £229 million is in respect of the new HQ and £21 million relates to the IT element. In addition, the UP includes total interest of £320 million and total service costs of £15 million. (Total value of UP over 30 years is £560 million). The values of the five plots included in the Barter Deal are shown below. The year YEAR-1 is the year prior to the contract coming into effect.

	Book values	Barter Deal Values				
		1 April YEAR-1	1 April YEAR0	1 April YEAR1	1 April YEAR2	1 April YEAR4
Plot 1	4.5 million	4 million				
Plot 2	2.5 million	3 million				
Plot 3	4 million	4 million				
Plot 4	1.5 million	1 million				
Plot 5	13 million	13 million				

The schedule of UPs is as follows, starting in year beginning 1 April YEAR3.

1 April	31 March	£m	
YEAR3	YEAR4	23.5	1 year at 23.5 = 23.5

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YEAR4	YEAR10	23.25	6 years at 23.25 = 139.5
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YEAR10	X029	17.25	23 years at 17.25 = 396.75
-		0.25	Balancing payment
		<u>560</u>	Total

Accounting for the Barter Deal – asset valuations

The value of the plots in Department Yellow's accounts needs to be adjusted for 1 April YEAR0 to reflect the Barter Deal value at the future date of transfer, taking account of projected movements in value in the intervening period, during which the plots continue to be recognised as fixed assets by the Department. *(Note: this assumes that the values have been agreed at the time the contract is signed.)*

At 31 March YEAR0 (the end of year YEAR-1)	Budget impact	Resource accounts
Plot 1 The value is written down by £0.5 million	Resource DEL hit with write down in value	Dr Revaluation reserve or OCS (FRem 5.2.34) Cr Fixed assets
Plot 2 Upwards revaluation to £3 million	None	Dr Fixed assets Cr Revaluation reserve
Plot 3 No change	None	None
Plot 4 The split between land and buildings is £0.75 million land and £0.75 million buildings. Without the PFI deal, the buildings had a remaining economic useful life of 10 years, with a residual value of £0.3 million. It is assumed that the value of the plot at 1 April YEAR4 will comprise land at £0.75 million and buildings at £0.25 million. Department Yellow has four years' use of the property. The value of plot 4 is written down to £1.20 million, comprising land at £0.75 million and buildings at £0.45 million. Over the four years ending March YEAR1, YEAR2, YEAR3 and YEAR4, depreciation of £0.05 will be charged annually.	Resource DEL hit with the write down of £0.3 million Routine depreciation is reflected in non-cash	Dr Revaluation reserve or OCS (FRem 5.2.34) Cr Fixed assets Routine accounting entries
Plot 5 The split between land and buildings is £10 million land and £3 million buildings. Because the transfers are not due to take place until YEAR10, the value at YEAR-1 is agreed as proxy for the value at YEAR10, taking into account increases in land values offset by changes in the value of the buildings on the site.	None	None

Accounting for the Barter Deal – transfers of property prior to occupation

Department Yellow accounts for the plots as they are transferred to the Consortium prior to the occupation of the new accommodation as follows:

	Date of transfer	Value	Budget impact	Resource accounts
Plot 1	1 April YEAR0	£4 million	Negative CDEL for the NBV of the transfer	Dr Prepayments Cr Fixed assets
Plot 2	1 April YEAR1	£3 million	Negative CDEL for the NBV of the transfer	Dr Prepayments Cr Fixed assets
Plot 3	1 April YEAR2	£4 million	Negative CDEL for the NBV of the transfer	Dr Prepayments Cr Fixed assets

Accounting for the occupation of the new building

When Department Yellow occupies the new accommodation, the property is valued at £250 million (see background section) and is brought on balance sheet.

The accounting entries are:

Dr Fixed assets
Cr Long-term lease creditor

The £250 million is a capital DEL hit.

Accounting for the transfer of Plot 4

Department Yellow accounts for the transfer of Plot 4 after the occupation of the new building as follows:

	Date of transfer	Value	Budget impact	Resource accounts
Plot 4	1 April YEAR4	£1 million	None	Dr Long term creditor Cr Fixed assets

Subsequent accounting

Each year until the end of the lease, there will be a cash requirement in respect of the UP. There will be a resource DEL hit in respect of the service element of the UP and of the difference between an interest rate of 3.5% and the imputed interest rate (and depreciation and the cost of capital charge on the asset). The capital repayment, the interest up to the standard rate and the cost of capital credit are outside budgets.

The accounting entries are:

Dr Long-term lease creditor for capital element of UP
Dr Operating Cost Statement for service and interest elements of UP
Cr Cash

(In addition to the service and interest elements, depreciation and cost of capital charges and credits also pass through the OCS.)

In addition, Department Yellow can now start to release the prepayment. Because it represents the lower service payment, it should be released over the period of the reduced service payment (in this example, considered to be the life of the contract).

The accounting entries are:

Dr OCS

Cr Prepayment

The release has no budgetary impact.

Department Yellow defers the final stage of the Barter Deal

In X008, Department Yellow determines that it needs to retain Plot 5 beyond YEAR10. Under the contract, therefore, the Department will have a cash requirement of £13 million to pay to the Consortium.

The accounting entries are:

Dr Long-term lease creditor

Cr Cash

Since the value of the Plot 5 is included in the overall valuation of the new accommodation, there is no DEL hit involved in the deferral. *(Note: the accounting entries do not deal with Supply in respect of the net cash requirement.)*

During the five years of the deferral, the Department will continue to revalue and depreciate Plot 5 in the normal manner.

Final deal

Under the terms of the contract, Department Yellow has to vacate the property in X015, and the Consortium pays to the Department the value of the property at that date.

The accounting entries are:

Dr Cash

Cr Fixed Assets

There is no DEL impact. *(Note: the accounting entries do not deal with the surrender of the proceeds of sale.)*