

CHAPTER 10 – SUPPORT FOR LOCAL AUTHORITIES

Overview

451. Departmental budgets include Government support for local authorities. They do not include self-financed local authority spending.

Resource Budget

452. The resource budget includes current grants to local authorities.
453. DRAs do not distinguish between current and capital grants. Both go through the OCS. National accounts do distinguish between current and capital grants, and the budgeting treatment follows the national accounts distinction, with capital grants going through the capital budget.

Capital Budget

454. Capital budgets include:
- # Supported Capital Expenditure (Capital)
 - # Supported Capital Expenditure (Revenue)

Supported Capital Expenditure (Capital)

455. Supported Capital Expenditure (Capital) is the local government finance term for capital grants. Capital grants may be distinguished from current grants in that capital grants have to be used by local authorities to:
- # buy capital assets (land, buildings, machinery &c); or
 - # buy stocks; or
 - # pay capital grants to an individual or enterprise in the private sector or to a public corporation.
456. Where grants are paid that may be used at the recipient's discretion either on capital or on current expenditure they should be treated as current grants.
457. Payments of compensation to local authorities for capital goods destroyed or damaged by natural disasters count as capital grants.

Supported Capital Expenditure (Revenue)

458. Supported Capital Expenditure (Revenue) (SCE(R)) is the local government finance term for a promise by government to make available a stream of current support for local authority borrowing (including on balance sheet PFI) for the purpose of acquiring capital assets.
459. Departmental budgets score the capital value of SCE(R). The current support is paid by ODPM (Local Government) as part of the Revenue Support Grant.

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- 460. For certain outturn years, departments score the capital values of the predecessor regime, credit approvals.
- 461. Self-financed borrowing by local authorities under the prudential borrowing regime that is not supported by Government does not score in departmental budgets.

Switching between Support for Local Authorities and Other Spending

- 462. From financial year 2006-07 local government will operate under a system of three-year settlements. The first three-year settlement will cover 2006-07 and 2007-08 in order to synchronise with the Spending Review timetable. Local government finance settlements will set the levels of Revenue Support Grant for three years.
- 463. Departments will, as far as possible, also allocate specific revenue and capital grants on the same basis. This means that levels of support for local authorities will effectively be set and will not be open to change.
- 464. Where departments wish to add to support through creation of a new grant, or to alter the basis of an existing grant, they should consult the Treasury and ODPM. . Departments should, however, note that the Government's policy is to reduce the amount of additional specific grants to local government, and in particular is committed to reducing the number of ring-fenced specific grants.

Debt Repayment Grants

- 465. Grants to enable local authorities to repay debt principal do not score in budgets. Any payment of such a grant requires specific Treasury approval. Where appropriate, approval of such a grant will be associated with offsetting budgetary adjustments.
- 466. Where a department gives a grant that covers both debt repayment and the payment of any associated debt interest premia by the Local Authority to the debt provider, then the two elements of the grant should be separated. The element that covers premia should score as a current grant in budgets.
- 467. Where an Local Authority uses a debt repayment grant to repay debt and receives a discount on that debt because of that then:
 - # in the majority of cases the department will have paid a grant to the Local Authority that was less than the amount of debt principal. The whole of the grant would count as a debt repayment grant;
 - # if the department shares in the value of the discount in the form of a payment from the LA this income will score outside budgets.

NDPB Support to Local Authorities

- 468. NDPBs support to Local Authorities is treated in the same way as support for Local Authorities provided by departments.

PFI Credits

469. PFI Credits are a promise by government to make available a stream of current support for local authorities who undertake PFI schemes that are off balance sheet. PFI credits are a proxy for the level of capital expenditure undertaken in a given PFI scheme and the stream of current support represents the cost of financing that capital expenditure.
470. PFI credits are outside budgets. However, as part of the SR settlement departments are allocated a specific amount of PFI credits. Departments may not exceed this amount except as provided below.
471. The current support is paid by ODPM (Local Government).

Switching between PFI Credits and Supported Capital Expenditure

472. Departments may not switch PFI credits into Supported Capital Expenditure (Capital).
473. Departments may freely switch Supported Capital Expenditure (Revenue) into PFI Credits. Departments' CDEL cover would be reduced and their non-budget provision for PFI Credits would be increased. Talk to your Treasury spending team if you wish to make such a switch.

Public Corporations accountable to Local Authorities

474. Transactions between Local Authorities and their public corporations are recorded as transactions between those two sectors. If a department provides grants to a local authority which it in turn uses to support its public corporations then the transaction at the departmental level should be recorded as a transaction between central and local government, in resource or capital budgets as appropriate.
475. Similarly, where a department provides SCE(R) which is for ultimate use by a public corporation accountable to a local authority it will score in the department's budget in the usual way.

Capitalisation Directions

476. ODPM and the devolved administrations have the power to issue directions to local authorities to capitalise certain expenditure. Such directions do not change the nature of the expenditure from current to capital. Rather, they allow local authorities to borrow in order to finance current spending.
477. There may be arguments for allowing local authorities to spread the incidence of certain lumpy current expenditure payments such as large redundancy payments in order to smooth the path of Council Tax. However, capitalisation directions contravene the principles of the golden rule.
478. Therefore departments and devolved administrations contemplating issuing a capitalisation direction should discuss the case with the Treasury's local government team before doing so.

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479. The impact of capitalisation directions on departmental and devolved administration budgets is under review.

New Burdens on Local Authorities

480. Where departments add to the burdens of local authorities they need to make funding available to local authorities by a budget transfer. Departments contemplating a new burden should contact ODPM on the procedures to be followed – see Annex B for contacts.

CHAPTER 11 - PUBLIC CORPORATIONS

Definition of Public Corporations

481. Public Corporations (PCs) are defined for the National Accounts by the Office for National Statistics (ONS). ONS publish a list of PCs in the publication MA23 (see Annex C for links). If a body is not listed in MA23 and you are in doubt as to whether it is a PC, or if you are considering setting up a body that might be a PC, you should contact HM Treasury.
482. PCs are bodies that are controlled by government or another public corporation and that are market bodies, i.e. their income comes mainly from trading activities. Certain regulatory activities may count as trading.
483. PCs may take various legal forms, including statutory bodies and Companies Act companies. Not all Government-owned Companies Act companies are PCs, they may be NDPBs.
484. Most **trading funds** are PCs. However, trading fund is a legal designation leading to a particular Estimates treatment. The ONS need to consider separately whether a particular trading fund meets the national accounts criteria for PC status. This chapter applies to trading funds that are PCs, with some special features – see below. Those trading funds that are not PCs are budgeted for as departments or NDPBs as appropriate. At present the only trading fund that is not a PC is DVLA.
485. Some **Public Private Partnerships** (PPPs) may be PCs - see the passage on PPPs below. If they are PCs they are budgeted for like other PCs.
486. Certain special arrangements apply to **self-financing public corporations** (SFPCs), which are set out below in this chapter.
487. This chapter applies to public corporations answerable to Ministers. UK subsidiaries of a public corporation are included within the budgeting controls of the parent public corporation. Departments should discuss with the Treasury the budgeting arrangements for non-resident subsidiaries of a public corporation. These budgeting rules also apply to public corporations that are a joint venture of one or more public corporations accountable to Ministers. Different arrangements apply to public corporations answerable to local authorities (see chapter on support for local authorities).

The Objectives of the Budgeting System

488. The **aims of the budgeting framework** with regards to public corporations are:
 - # To support the government's fiscal objectives;

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- # To provide sensible and transparent incentives to managers in public corporations and in departments. This implies both:
 - ~ Ensuring that public corporations and their sponsoring departments face good incentives for the PC to generate the right return on capital; and
 - ~ appropriate levels of freedom to exercise commercial judgement, within appropriate delegated authority arrangements that protect departments.
- 489. In addition, the budgeting framework aims to reduce compliance costs for departments by being based as far as is practicable on entries in departmental resource accounts.
- 490. The Government's **fiscal framework** applies to the whole of the public sector, that is general government (central and local government) and public corporations. In the fiscal framework:
 - # PCs' gross operating surplus is a benefit to the current balance used to measure the golden rule. Payments of interest and dividends to the private sector and depreciation make the current balance worse; and
 - # PCs' investment increases Net Borrowing, and their liabilities contribute to net debt.
- 491. The EC's Maastricht debt and deficit measures apply to general government. So they exclude the performance and spending of public corporations but include certain of departments' transactions with public corporations. That helps to explain why we need accurate measures of government's dealings with public corporations even though domestically we measure performance at the public sector level.
- 492. It is for departments to manage their relationship with their public corporations in the way that best meets their needs. Departments should take advice from the **Shareholder Executive** where appropriate. The Shareholder Executive are based in the DTI but operate both in an executive function for departments in relation to some PCs and as advisors alongside departmental shareholder team for others. The Treasury issues guidance on public corporations policy in general and on trading funds policy.
- 493. Departments are expected to set PCs clear objectives and challenging targets covering return on capital employed, dividend levels, efficiency, and quality of goods and services. The corporate plans of PCs should be subject to agreement by the department. That is particularly important where PCs have been under-performing against profits targets, face risks to performance, or might generate substantial levels of excess cash.

Two Bases for Scoring Public Corporations

- 494. There are two bases for scoring public corporations:
 - # Most corporations score on an **external finance** basis;

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- # A few public corporations score on the **consolidation** basis*.
495. The effect on budgets and public corporations of the two bases is similar though not identical:
- # In both cases, the department bears a cost of capital charge in respect of the public corporation;
 - # In both cases, the cost of capital charge is offset by means of a return from the public corporation which scores in the Resource Budget, though the return comes in different forms:
 - ~ interest and dividends, in the case of public corporations scored on an external finance basis; and
 - ~ profit, in the case of public corporations scored on the consolidation basis.
- Where the department cannot obtain a return from the public corporation that covers the cost of capital, the department will suffer a shortfall in its Resource Budget. If the return exceeds the cost of capital, the department obtains a benefit to the Resource Budget;
- # In both cases Subsidies would score in the Resource Budget;
 - # Capital budgets differ in their scoring:
 - ~ the external finance basis scores sources of finance (capital grants, borrowing) that supplement the public corporation's internal resources, and leaves public corporations free to spend self-generated funds on capital;
 - ~ the consolidation basis scores the public corporation's capital expenditure.
496. Departments should use the external finance basis except where the Treasury has agreed that the consolidation basis may be used. A reason for using the consolidation basis is where there is no legal power to obtain from the public corporation payments of interest, dividend or sums of an equivalent nature to cover the cost of capital.
497. This guidance now sets out the treatment of the common elements in budgeting:
- # the capital base and the cost of capital charge, and
 - # subsidies.
498. The guidance then sets out separately the scoring of:
- # The external finance basis,
 - # The consolidation basis, and

* The consolidation basis was used for all public corporations under Stage I RAB. On the introduction of Stage II RAB all public corporations moved to the external finance basis apart from Forest Enterprise (and NHS trusts, since reclassified to the central government sector – see next Chapter on budgeting for NHS trusts).

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- # The treatment of Self Financing Public Corporations, where the DEL/AME treatment is different from other public corporations, but which otherwise score on the same bases as other PCs.

499. The table below sets out the main elements of the two bases of scoring in budgets in summary form:

	Resource Budget	Capital Budget
External finance basis	Cost of capital charge in respect of public corporations Subsidies paid to public corporations <i>Less</i> Interest and dividends received from public corporations	Investment grants paid to public corporations Net lending to public corporations Public corporations' market and overseas borrowing (including on balance sheet PFI) <i>Less</i> equity withdrawals from public corporations
Consolidation basis	Cost of capital charge in respect of public corporations Subsidies paid to public corporations <i>Less</i> profit/ <i>plus</i> loss of public corporations	Capital expenditure of public corporations <i>net of</i> book value of sales of capital assets

Capital employed and the cost of capital charge

500. Departments bear a cost of capital charge in respect of their ownership of, or responsibility for, a PC, based on their share of the underlying net assets (Capital Employed) of the PC.

501. The charge is payable where:

- # a department has an actual investment in a PC (normally equity or loans including PDC where applicable); and
- # where a department has no actual investment in a PC, except where the Treasury has agreed that it would be clearly inappropriate to include a cost of capital charge.

Cost of Capital Charge and Accounts

502. Where there is a cost of capital charge in accounts, the charge in budgets will be the same.

503. Where budgets include a cost of capital charge and accounts do not the charge is worked out in the same way as for PCs where a cost of capital charge is shown in accounts.

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Setting the Rate of Return on Capital Employed

Weighted Average Cost of Capital

504. Departments should begin by establishing an appropriate post-tax Weighted Average Cost of Capital (WACC) for the PC. To work out the WACC, departments should consider the whole of the Capital Employed in the PC, not just the department's share.
505. Looked at from funding, Capital Employed comprises total equity, reserves, debt including all interest bearing liabilities and un-funded or under-funded pension liabilities.
506. The appropriate WACC should be calculated using a cost of equity and cost of debt commensurate with the returns equity and debt investors would expect to receive from investing in a comparable private sector business with the same level of risk.

Setting a Target Rate of Return

507. A PC should be set a target return to earn at least its WACC multiplied by the overall Capital Employed. You should use the average Capital Employed over the year.
508. In the case of PCs performing essentially government-type functions, 3.5% real will normally be appropriate. A PC competing in the market should typically be expected to return a higher rate to reflect the prevailing market rate. In 2005-06 these rates are in the range 5.5% to 15%.
509. Where a PC has a monopoly, departments should ensure that the rate of return set is not exploitative.
510. The right rate for the PC should be agreed with the Treasury when a new PC is set up and as part of the SR process.

The Department's Cost of Capital Charge

511. Once the total Capital Employed has been worked out, the department's share of it is calculated by deducting those elements on which the public corporation owes a return to another funder.
512. In principle, the calculation is Capital Employed:
 - # *Minus* loans from the private sector, including finance leases and other interest bearing liabilities;
 - # *Minus* the value of private sector equity stakes in the business;
 - # *Minus* unfunded or under-funded pension liabilities (which are a sort of debt owed to the private sector).
513. The Department's cost of capital charge is then worked out so as to represent the return the department should expect on *its* investment in the PC, ie:
 - # The department's share of the Capital Employed, as determined above, multiplied by the WACC;

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- # Less the amount of interest that the PC has to pay on any NLF loan (since the departmental asset in respect of a NLF loan is matched by a liability to the NLF).

Regulated Businesses

514. For some regulated businesses it may be appropriate to use a Regulatory Asset Base or Regulatory Capital Value (RCV) in respect of all or part of the PC as the Capital Base upon which a cost of capital charge is levied. If you think that would be the appropriate Capital Base you should talk to HM Treasury.

Tax Planning

515. The Government obtains a return from public corporations partly through the normal tax on corporations and partly as owner. Public corporations may undertake normal tax planning but should not incur wasteful expenditure on tax mitigation.
516. The passage on WACC above assumed that public corporations have not operated in a way designed to reduce their tax bill. Where public corporations have undertaken tax mitigation – in particular where public corporations have high levels of interest-bearing debt – departments should consult the Treasury on how to work out the WACC so as to counter-act the effects of tax mitigation.
517. DAO(GEN)08/03 gives more guidance to departments and NDPBs on tax planning.

Trading Funds

518. Trading funds that are public corporations are normally budgeted for exactly like other public corporations.

Trading Funds that are Departments in their Own Right

519. There are some special points to note about how to obtain this equivalent budgeting treatment where the trading fund is a department in its own right.
520. Here, a **cost of capital charge** will be shown in the budget of the department that is treated as parent department for budgeting purposes (even though there may be no parent department for accounting purposes).
521. As with other PCs, where the trading fund borrows directly from the National Loans Fund the amount of the capital charge is abated by the interest it pays on that borrowing.
522. There are differences in the treatment of **loans made directly by the National Loans Fund to a Trading Fund** that is a department in its own right:
- # for accounting purposes, the parent department does not recognise the loans arranged by the Trading Fund directly with the NLF. The parent department would recognise the value of its investment in the Trading Fund at the historical cost of the PDC.

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- # But for budgeting, borrowing by the Trading Fund scores in the parent department's capital DEL. That includes NLF loans. Loan repayments - although made directly to the NLF - score as a credit to the parent department's Capital DEL.

Subsidies

523. Subsidies are unrequited current payments to trading bodies:

- # “Unrequited” payments should be distinguished from payments for goods and services, where the department obtains something direct in return for the payment. That the department obtains a general policy benefit from a subsidy does not stop it being unrequited.
- # DRAs do not distinguish between subsidies and capital grants. Departments need to do so for budgets following national accounts principles. The distinction is needed because subsidy and expenditure financed by capital grants score differently in the fiscal framework: in effect subsidies affect the current balance used to measure performance against the golden rule, while capital grants do not. Capital grants are unrequited transfer payments that are intended to finance investment by the PC (see below).

Under-performance

524. Departments have to obtain a return from their PCs that covers the cost of capital charge agreed with the Treasury. Depending on the scoring basis, the return either comes in the form of interest and dividend income from the PC or in the form of profit. In order to be able to pay the necessary amount of interest and dividends, the PC needs to make enough profit, and the department should ensure that the PC is set a sufficiently challenging profits target and that it meets it. A dividend policy should then be agreed between the PC and its department as shareholder.
525. If the PC does not make enough profit to cover the cost of capital charge or to enable it to pay the right level of interest and dividends, the department should pay a subsidy to the PC so that it can make those payments. The reason for this requirement is to make it transparent to Parliament and public that a PC is under-performing and needs a subsidy to be paid. Where a department has no power to pay a subsidy, the overall effect on budgets is still the same, since it is the initial shortfall in PC performance against the cost of capital that impacts on the Budget.
526. No subsidy need be paid if the Treasury and the department agree that the PC's underperformance was due to normal volatility.
527. It is important to make clear to PCs that only making the expected levels of profit after receiving a general subsidy is not good enough. The payment of a subsidy needs to be accompanied by the PC's development of a recovery plan to get performance back on track.

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Social Policies

528. Where a department wishes a PC to perform a social policy function then it should pay for that explicitly out of its budget rather than seeking to recover the costs by accepting PC underperformance or by over-charging PC customers. A department has two choices:
- # It may pay a subsidy to the PC; or
 - # It may treat the PC as a handling agent. Here the department would pay the PC for its services in handling a transaction, while the transaction itself would score in the books of the department acting as principal. This route should be used when PCs are involved in the payment of grants to the private sector or local authorities, since grant-giving is not a market activity appropriate to PCs.
529. It may be appropriate for subsidies to be paid by a department other than the sponsoring department where it is the other department that wants the social policy function to be carried out.
530. Where a department wishes a PC to perform a social policy function and does not have legal power to pay a subsidy the department should contact HM Treasury to establish how best to obtain transparency.

Early Debt Redemption

531. Where a department supports a PC to repay debt early and the PC has to pay an interest rate premium, the element of grant that covers the premium scores as a subsidy.
532. That is the case even if the department makes a single grant payment in support of both principal repayment and early redemption premia: the two elements must be divided into a subsidy and a capital grant.
533. Where the department is supporting only a part of the PC's total payment covering debt repayment and premium, the grant should be divided into subsidy and capital grant in the same proportions as the total payment by the PC is divided into premium and debt principal repayment.

External Finance Basis

534. This section sets out the resource budget and capital budget scoring of public corporations on an external finance basis.

Resource Budget

535. For a public corporation the departmental Resource DEL scores:
- # subsidies paid to the PC
 - # a cost of capital charge
 - # *minus* interest and dividend income received by departments from PCs (including interest on NLF loans) *plus* interest payable to the NLF

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- # *plus* a charge for bad debt for any loans from the department to the PC that have been written off because the PC is unable to repay them
- # *plus* a charge for the impairment of any investment in PCs if it falls below historic cost

Interest

536. When debts are repaid early,

- # Interest premia received from the PC count as current income in the DRA alongside other interest
- # Interest rate discounts paid by the department to the PC count as current payments in resource DEL alongside other payments of interest a department may make.

NLF Interest

537. Where a department's accounts show interest payable from PCs in respect of NLF loans and the subsequent payment of interest to the NLF then both should be reflected in the resource budget.

Dividends

538. A dividend policy should be agreed between the PC and its department as shareholder. The department may choose not to recover the full cost of capital charge as a dividend (in order to allow for reinvestment of its profits by the PC). But, if it does not cover the cost of capital charge, the difference will be a charge on its Resource DEL.

539. Note that the Operating Cost Statement (OCS), and budgets, will in Year 1 record the dividends expected to be received in respect of year 1, even though the cash will not be received until Year 2. That way dividend income covers the cost of capital charge for the year to which it relates.

540. Not all income treated as dividends in DRAs counts as a dividend for budgeting. Please see the section on equity withdrawals below.

Capital Budget

541. The capital budget scores:

- # Capital grants paid by the department to the PC
- # loans to the PC (includes voted loans, National Loans Fund loans and Public Works Loan Board loans), net of repayments
- # Public Corporations Market and Overseas Borrowing net of repayments (PCMOB)
- # injections of equity into PCs net of repayments of equity by PCs. Equity includes Companies Act shares and Public Dividend Capital
- # *minus* equity withdrawals.

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542. Loans score in the capital budget whatever their purpose, that is whether they have been taken out to finance working capital or fixed assets investment.
543. Note that the capital budget does not score capital expenditure by the PC, only the external support for capital expenditure. Subject to their agreeing their business plans with their department as shareholder, PCs are therefore free to invest insofar as they are able to finance their investment from asset sales, income that covers depreciation and a level of profits that exceeds what is needed to pay interest and dividends as agreed with the department.

Capital Grants

544. Capital grants are unrequited transfer payments that are intended to finance investment by the PC. Investment includes the acquisition of any capital asset (land, buildings, vehicles, machinery &c) and any financial asset (lending, company securities &c). Grants to finance stock building should also be treated as capital grants. Grants to refinance pension funds are capital grants.
545. Capital grants should be paid whenever the NLF has made a loan to a PC that the PC would otherwise be unable to repay – this demonstrates transparency to Parliament. For voted loans, follow the procedures in *Government Accounting*.
546. Capital grants should also be paid where a department wishes a PC not to be burdened by a loan that it could repay, perhaps as part of a restructuring.
547. Where a department supports a PC to repay debt early and the PC has to pay an interest rate premium, only the element of grant support that covers debt principal scores as a capital grant. The element that covers the premium scores as a subsidy.
548. Grants from the department to make good a shortfall in a real pension fund score as capital grants in budgets and may need special recording. Departments contemplating such a grant should contact the Treasury.

Public Corporations' Market and Overseas Borrowing (PCMOB)

549. Expenditure financed by PCMOB scores in the Government's fiscal framework like any other expenditure. Therefore PCMOB should be controlled. Where PCs wish to borrow on the market or overseas, departments should discuss proposals (other than for overdrafts) with HM Treasury. Approval for borrowing from the private sector will be permitted only in exceptional cases.
550. PCs may normally only borrow from the market or overseas where at least one of the following applies:
- # A facility is not provided by the public sector, for example overdrafts, and that facility is either necessary to the normal conduct of business or offers better value for money than other forms of finance;

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- # It would be cheaper for the PC to borrow on the market than for the government to borrow – this will almost never be the case, although some bodies may offer cheap loans, for example the European Investment Bank. Where a PC or department believes that a body's borrowing would be cheaper than the Exchequer's cost of borrowing it should first verify the assessment with the Treasury;
 - # It would be better value for money for the PC to borrow on the market than to borrow from Government. This might apply to some on balance sheet PFI procurement, for example;
 - # There is no power for government to lend to the PC.
551. PCMOB scores in budgets as external finance.
552. PCMOB does not include movements in PCs' bank deposits. PCMOB also does not include policy lending, that is lending undertaken in pursuit of the policy objectives of the Public Corporation rather than as a purely money management transaction.
553. Further details of the Treasury's approach to lending to PCs, particularly ensuring an appropriate lending rate is used, can be found in DAO(GEN)13/04 and PES(2001)05 – see Annex C for the link.

Excess Cash Balances and Equity Withdrawals

554. Departments should ensure that PCs do not build up excessive cash balances. Cash balances are excessive if they are more than the amount needed to fund expenditure in the next three years as set out in the corporate plan that has been agreed with the department. Excess cash balances should be taken out of PCs so that the spending power that they represent is prioritised across the departmental group as a whole. Excess cash balances are normally taken out by means of equity withdrawals.
555. Equity withdrawals benefit Capital Budgets. So a department may in effect borrow spending power from its PC, extracting cash in one year (obtaining a Capital DEL benefit) and making spending power available to the PC through Capital DEL in a later year.
556. Equity withdrawals are exceptional payments from accumulated reserves or cash balances. They should be distinguished from dividends in that dividends should be paid out of the profits of the current year or the two previous years.
557. Equity withdrawals do not need to result in an actual repayment of shares or PDC. That is, they may simply be a cash transaction.
558. In DRAs, equity withdrawal of this type will go through the OCS as special dividends, in the same way as ordinary dividends. There is no impact on the department's balance sheet other than the increase in cash. However because of the differing treatment in national accounts and budgets departments need to distinguish equity withdrawals from dividends according to the principles described above.

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559. In the national accounts for general government, income from dividends scores as current income, while income from equity withdrawals scores 'below the line' as a financial transaction. They thus have a different impact on certain of the fiscal measures.
560. Where equity withdrawals do result in an actual repayment of shares or PDC then there is no difference in treatment between DRAs and budgets. The double entry in DRAs would be to reduce fixed assets and increase cash. Where a profit is taken to the OCS the department should discuss proposals with their Treasury Spending team.

Consolidation Basis

561. The only public corporation that scores on the consolidation basis is Forest Enterprises, a PC that forms part of the Forestry Commission. However, the new requirement that from 2006-07 resource budgets will score a cost of capital charge in respect of all public corporations irrespective of whether the department has an investment may lead to an increase in the bodies scored on this basis.

Resource Budget

562. For a public corporation on the consolidation basis the departmental Resource DEL scores:
- # subsidies paid to the PC
 - # a cost of capital charge
 - # the PC's profit (negative sign, ie benefit to the Resource Budget) or loss (positive sign, a cost in the Resource Budget); and
 - # *plus* a charge for bad debt for any loans from the department to the PC that have been written off because the PC is unable to repay them.
563. It follows that interest and dividend income from public corporations is a non-budget transaction.

Calculation of Profit/ Loss

564. The definition of profit or loss should normally be based on that used in the public corporation's own published accounts. The accounts basis should be current cost where this information is available. The following rules apply:
- # profit should be struck after taking account of any subsidy received (ie treating subsidy alongside trading income);
 - # profit should be struck after payment of tax;
 - # profit should be struck after interest income on deposits and other loans made by the public corporation (different rules apply to some trading funds);
 - # profit should normally be struck before payment of interest and dividend to the department, but after payment of interest on NLF loans;

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- # profit should be struck after payment of interest and dividends to the private sector and abroad;
- # profit should be struck after non-cash items such as depreciation, impairments and movements in provisions;
- # where the public corporation has a pension fund deficit, the profit measure should be after the deduction of implied interest on that deficit. Implied interest should be worked out by applying the cost of debt (used in the WACC) multiplied by the amount of the pension deficit;
- # profit should be struck after reversing the benefit of any release from the public corporation's donated assets reserve (or similar) where the grant was provided by the sponsor department or the European Community (public corporations should benefit in the profit and loss account from the release from the donated assets reserve (or similar) for donations from the private sector and for Lottery grants); and
- # profit should be on a global basis after consolidating all subsidiaries. If a UK company is treated for the national accounts as a subsidiary of the public corporation then it should be treated as a subsidiary for budgeting. Overseas subsidiaries should also be consolidated.

Monitoring Provisions

565. Public corporation profit/ loss is treated as near-cash in budgets. Generally that is the appropriate treatment. It can go wrong, however, if the calculation of profit is heavily influenced by the take-up of provisions, or if there is a significant utilisation of provisions leading to cash outflows being charged to the balance sheet.
566. Departments are therefore asked specifically to monitor the movements in provisions of public corporations and to talk with their Treasury spending team if these movements become significant.

Capital Budget

567. The parent department's Capital DEL scores:
- # capital expenditure by the PC;
 - # /less book value of disposals (profit and loss on disposals is in the calculation of profits).
568. It follows that the department's capital transactions with the PC (capital grants, loans, equity withdrawals) are non-budget transfers. PCMOB does not score in budgets, but the capital expenditure that is supported by external finance (including on balance sheet PFI - see later chapter) does score.
569. However, grants from the department to make good a shortfall in a real pension fund score as capital grants in budgets. That is the case even where the grant is paid to the PC, because it will not score in the PC's

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own capital expenditure. Departments contemplating such a grant should contact the Treasury..

Excess Cash Balances

570. As with other PCs, departments have a duty to ensure that PCs do not build up excess cash balances. The extraction of cash balances from a PC on a consolidation basis has no effect on budgets. Similarly, if the PC later needs cash from the department to finance capital expenditure the cash transfer will have no cost in budgets, though the capital expenditure will score.

PFI

571. For the treatment of PFI in budgets, please see the chapter on PFI.

Treatment of Self-Financing Public Corporations

572. Certain PCs have been designated by the Treasury as SFPCs and have special scoring. The scoring affects the AME or DEL treatment of spending. All SFPCs at present are scored on the external finance basis as set out above.

Rationale and Criteria for SFPCs

573. The main rationale underpinning SFPCs is that the Spending Review is used to prioritise spending financed by taxes. Where public corporations expect to recover expenditure from fee-payers in a competitive open market that expenditure may be excluded from the SR prioritisation process.

574. However, SFPCs are still public bodies, their spending is still public spending, their activities impact on the fiscal framework, and their liabilities contribute to net debt. They therefore need to be managed and monitored.

575. It is for the Chief Secretary to the Treasury to designate a SFPC where it is appropriate to the Treasury's conduct of the SR. The criteria that guide the Chief Secretary include:

- # The PC must have traded profitably for a number of years, not requiring subsidies, and must be able to demonstrate that this state of affairs will continue into the future;
- # The PC must be selling goods and services into an open market. It should not be selling regulatory services;
- # The PC must either:
 - ~ Be selling primarily to customers outside general government; or
 - ~ be a publicly announced candidate for privatisation or a PPP in the private sector.

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List of SFPCs

576. The following PCs have been designated as SFPCs: Royal Mail Holdings plc, QinetiQ, BNFL, Commonwealth Development Corporation, Channel 4, Crown Estate, the Royal Mint and the Tote. The BBC is also treated like an SFPC.

Control of SFPCs

577. Self-Financing Public Corporations are controlled by departments in the same way as other PCs. In the SR, departments agree a forward plan in respect of the SFPCs alongside but not in the normal SR process. As with other spending in AME, performance against the plan is monitored formally by departments and the Treasury in the run-up to each Budget and Pre-Budget report.

578. The plan will include the appropriate cost of capital and the arrangements for underperformance, see below.

Scoring in Budgets

579. Self-Financing Public Corporations face the same budgeting rules and are scored in the same way as set out above, except that certain transactions score in AME rather than DEL. So, for SFPCs budgeted for on the external finance basis:

Resource AME scores:

~ A cost of capital charge

~ *minus* interest and *minus* dividends paid by the SFPC to the department;

Resource DEL scores:

~ Any subsidy paid by the department

Capital AME scores:

~ loans to SFPCs (net)

~ equity injections in SFPCs (net)

~ purchase or sale of the shares of SFPCs

~ *minus* capital repayments made by SFPCs

~ *minus* equity withdrawals

~ *plus* PCMOB (net)

Capital DEL scores:

~ Any capital grants paid to SFPCs

580. The subsidy formally paid to the Crown Estate to cover certain administration costs scores in Resource AME. Dividend income received from the Crown Estate is outside budgets.

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Underperformance by SFPCs

581. SFPCs should cover the cost of capital through their payments of interest and dividends.
582. Where SFPCs under-perform, the arrangements set out in PES 2002 (13) Scoring of Self Financing Public Corporations in DEL in the 2002 Spending Review apply.
583. Where appropriate, departments will take a DEL hit for under-performance by SFPCs.

Public Private Partnerships

584. PPPs that are entities in their own right may be classified by the ONS to the public or private sectors. In some PPPs, shares may be sold and the PC remains in the public sector (e.g. QinetiQ following its PPP). In other cases (e.g. NATS), shares may be sold and the PC may move into the private sector. The ONS takes into account a range of factors when considering classification and not simply the percentage of government shareholding.

Private Sector PPPs.

585. The holding of shares in a private sector PPP is the holding of an investment. The cost of capital charge scores in the Resource Budget DEL in the normal way, as does interest and dividend income.
586. Purchase of shares in a private sector PPP and net lending to a private sector PPP scores in Capital Budget DEL like other financial transactions.
587. Sale of shares in a private sector PPP is the disposal of a financial asset by the department. The income scores as a benefit to the Capital Budget: AME.

Public Sector PPPs.

588. Sale of shares in a public sector PPP is a form of public sector market borrowing, whether it is undertaken by the PC or by the department. So any cash received by the borrower is not a benefit to budgets. PCMOB is a cost in budgets.
589. In the case of SFPCs, PCMOB may only be undertaken in line with the agreed forward plan. The plan will set out what should be done with the sum realised by a share sale. In default of other arrangements, the sum should be taken out of the SFPC by way of an equity withdrawal in order to offset the PCMOB.

Privatisation

590. Sale of shares on the privatisation of a public corporation is the disposal of a financial asset by the department. The income scores as a benefit to the Capital Budget: AME.

Supplementary Information on Public Corporations

591. Departments are asked to provide certain financial information about PCs in addition to the budget data.

Capital Expenditure

592. Even though for most PCs capital expenditure does not score in budgets we ask departments to obtain information about all PCs' outturn and plan capital expenditure and to pass it on to the Treasury via COINS using a non-budget identifier.

593. This information needs to be accurate and kept up to date because:

- # It is information that departments should use in any event as part of their monitoring of PCs
- # The information feeds into the national accounts measures of spending and borrowing, including the fiscal framework
- # The information is published in PESA separately for each PC and is used in the functional and regional analyses of public sector spending, including tables that appear in Departmental Reports.

594. The information that is required is:

- # Capital expenditure net of (actual) sales proceeds. Capital expenditure includes land, buildings, vehicles and machinery
- # Additions to stocks (net)

Gross Operating Surplus

595. In addition, for the larger public corporations, the Treasury seeks special non-COINS returns of outturn and plan gross operating surplus (broadly, profit before depreciation).

596. This information is useful to the Treasury as gross operating surplus is an item on the revenue side of the Surplus on the Current Budget, used to measure achievement of the Golden Rule.

CHAPTER 12 - NHS TRUSTS

597. NHS trusts are central government bodies. Special budgeting arrangements apply to NHS producer trusts in England. These arrangements apply because:

- # NHS trusts were public corporations and some or all of those in England are expected to become public corporations again presently; and
- # The budgeting treatment supports the control framework of the NHS (England).

NHS Trusts (England)

Primary Care Trusts

598. NHS primary care trusts and other purchasing bodies in England score in budgets in the same way as other central government bodies – departments or NDPBs.
599. Their and DoH's payments to NHS producer trusts score as procurement spending or, exceptionally, subsidies. Capital grants and net lending to producer trusts do not score. Dividends and interest received from NHS trusts do not score in budgets.
600. The element of procurement that covers producer trusts' depreciation charges scores outside budgets. This non-budget treatment is under review.

Provider Trusts

601. This passage applies to NHS Foundation Trusts, NHS Hospital Trusts, NHS Ambulance Trusts and other NHS trusts that provide health care.
602. Trusts score on the same basis as public corporations on the consolidation basis (see the section *Consolidation Basis* in the previous chapter for details on how to work out these elements). So trusts score:
- # in Resource Budgets:
 - ~ trust profit and loss (profit is a negative number, ie a benefit to the Resource Budget, loss is a positive number, ie a cost)
 - ~ DoH cost of capital charge in respect of trusts
 - # In Capital Budgets:
 - ~ Trust capital expenditure net of the book value of sales
603. DoH dividend and interest income from trusts is not included in budgets.
604. Any capital grants, net lending or issues less repayments of PDC to NHS trusts do not score in budgets.

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NHS Foundation Trusts

605. The capital expenditure of NHS Foundation Trusts scores in Capital AME. The AME provision is created by a transfer from that year's CDEL provision. Any over- or under-expenditure against the AME provision leads to a corresponding adjustment to the following year's CDEL.
606. The profit/ loss of Foundation Trusts scores in RDEL.

Near-Cash/ Non-Cash

607. Appropriate arrangements are being introduced to cover the non-cash/ near-cash consequences for budgets of the control regime for NHS trusts.

NHS Trusts (Scotland, Wales and Northern Ireland)

608. NHS trusts in Scotland, Wales and Northern Ireland score in budgets in the same way as other central government bodies – departments or NDPBs.

PFI

609. For the scoring of PFI deals undertaken by NHS trusts, please see the chapter on PFI.

CHAPTER 13 – PENSIONS

610. This chapter has separate sections for the following cases:
- # A: Employing departments and NDPBs who contribute to multi-employer un-funded pension schemes
 - # B: Departments and NDPBs who contribute to and run funded pension schemes
 - # C: Departments and NDPBs who run their own un-funded, by analogy, pension schemes – that is schemes run by analogy to the multi-employer pension schemes
 - # D: Administrators who run multi-employer un-funded pension schemes
 - # E: Bulk transfers to funded schemes

Section A: Employing departments that contribute to multi-employer un-funded pension schemes

611. Departments are required to recognise in their budgets the accruing cost of their existing staffs' pension liabilities that will need to be met in future periods. For those departments whose staff are members of the large un-funded multi-employer schemes (such as the PCSPS) FRS 17 allows departments to account only for the contributions payable to the pension scheme administrator (the accruing superannuation liability charge or ASLC).
612. The employing department bears the cost of that ASLC in its Resource Budget DEL, as part of its salary bill.
613. The department bears no further liability in respect of pensions.
614. The employee may also pay a contribution into the scheme. Such payments are made by the employee out of her or his pay. The department will have shown pay as a cost in its Resource Budget DEL. It should not show anything further in respect of the employee contribution.

Section B: Departments and NDPBs who contribute to and run Funded Pension Schemes

615. Some departments and NDPBs run pension schemes with a real fund (as distinct from a notional fund). Such departments and NDPBs also have to comply with the accounting standard FRS17.
616. FRS17 covers the position where:
- # there is a deficit in the pension fund - i.e. there is a shortfall in the value of the assets of the scheme over the present value of the scheme's liabilities;
 - # The deficit is identifiable as belonging to the employer and
 - # the employer has a legal or constructive obligation to make good a deficit in the pension fund.

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617. In these circumstances, the employer should recognise that deficit in the fund as a liability. This liability should be recorded as a provision in the Resource Budget. It follows that there will be an associated cost of capital credit in the Resource Budget for any such liability.
618. The cost in the departmental budget is the same as that shown in the accounts of the department or NDPB under FRS17. Specifically the movement in the pension scheme liability as recorded in the OCS / I&E account scores as a cost in the non-cash resource budget. Any actual contribution to the scheme that serves to reduce the liability scores in the cash subsection of the resource budget offset by a negative non-cash amount. An example is given below.

Department or NDPB accounts	Resource Budget		Total
	Non-cash	Cash	
Increase in scheme liabilities			
Cr pensions liability	(110)		
Dr OCS / I&E	110	110	110
Contribute cash to scheme			
Dr liability	100	(100)	(100)
Cr cash	(100)		100
		10	100
		100	110

Example assumes that the contributing department pays 100 cash to the scheme but that the accruing cost of the pensions liability is 110

619. Where there is a surplus in the scheme, the department or NDPB should recognise that surplus as an asset if the conditions in FRS 17 are satisfied. There will be a benefit to the resource budget, as well as a cost of capital charge on the asset. Movements in the value of the surplus then impact on the OCS and resource budget.

Section C: Departments and NDPBs who run their own Un-funded, by analogy, pension schemes

620. “By analogy” means schemes run by analogy to the multi-employer pension schemes. The budgets of departments or their NDPBs that run un-funded by-analogy pension schemes should recognise the accruing cost of their existing staff’s pension liability that will need to be met in future periods. Such schemes should be accounted for on an FRS 17 basis.
621. The department or body that employs the staff recognises a provision on the balance sheet in respect of the accruing liability to pay pensions in the future, and a cost in their budget based on the change in that liability.

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Expenditure and Income scored in Resource Budget DEL

622. To ensure parity between those bodies who pay into multi-employer schemes and those bodies that run their own un-funded by-analogy schemes the costs borne by the by-analogy schemes in resource DEL are equivalent to those paid by departments who pay into the multi-employer schemes. Accordingly the following transactions score in the resource budget DEL:

Expenditure:

- ~ Increases in provisions due to current service cost
- ~ Increases in provisions due to any bulk / individual transfers in
- ~ Increases in provisions due to purchases of added years
- ~ Pensions benefits paid, offset by the release of a provision from the balance sheet
- ~ pensions benefits paid, if they are not charged to a provision on the balance sheet.

Income:

- ~ Income from bulk / individual transfers in (funds the increase in the provision due to transfers in)
- ~ Income from employees – normal (goes part way to fund the increase in the provision due to the current service cost)
- ~ Income from employees - added years (funds increase in the provision due to added years).

623. This treatment is analogous to multi-employer schemes because the current service cost borne by the department is broadly equivalent to the ASLC that would be paid to multi-employer pension scheme administrators.

Charges to Departmental AME

624. To ensure parity in the DEL treatment between those departments who pay into the multi-employer schemes and those that run their own un-funded by analogy schemes certain transactions score in Departmental AME:

- # The accounts - and therefore budgets - score the increase in the liability due to the unwinding of the discount rate. This increase is sometimes termed the interest on the scheme liability. It is currently made up of 2.8% real and 2.5% inflation assumption.
- # The provision liability attracts a cost of capital credit, the rate of which is set at 3.5% real and partly offsets the cost of the discount rate unwinding.

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Pensions Payable

625. Pensions payable and bulk and individual transfers out are charged to the provision and as such do not hit the departmental resource accounts. Nor do they have a net hit to budgets as expenditure.
626. However, the pensions in payment count as near-cash spending, and the release of the provision counts as non-cash. Normal rules on near-cash and non-cash switching apply (see Chapter above).
627. Bulk transfers to the private sector score as capital transactions in the national accounts and are treated as a cost in the resource budget offset by the release of provision.
628. As is the case with other provisions, COINS needs to record both these payments and the offset by the release of the provision. These data are needed for the national accounts.
629. Where payments are not covered by an existing provision they do score as charges in Departmental Resource DEL.

Board Members

630. Un-funded broadly by-analogy arrangements for chairs, vice-chairs, board members and other holders of public appointments are also subject to FRS17 and should be included in any measure of a body's un-funded liabilities.

Unfunded schemes that join the PCSPS / other multi-employer public sector unfunded pension scheme

631. Where an unfunded scheme joins the PCSPS it will be required to make a cash payment equivalent to the value of the liability that is being transferred. For the transferring body that has previously recognised a liability in its balance sheet in respect of its unfunded pensions liability, this will be a balance sheet transaction – a movement in cash and liabilities – with no impact on the OCS / I&E. It follows that there is no impact on budgets. However any amount of cash that is required above or below the liability previously recognised on the transferring body's balance sheet will be a cost / benefit to the OCS / I&E.
632. Budgetary cover for this debit or credit will be provided for as an AME item. The cash required for the transfer will be provided in the appropriate manner - either through supply or grant in aid to the body transferring the liability with no further impact on budgets.
633. For an unfunded scheme joining the PCSPS that has not previously recognised a provision on its balance sheet it follows that any payment it makes will be a cost in its OCS / I&E. Budgetary cover for this cost will be provided for in AME.

Section D: Administrators who run multi-employer unfunded pension schemes

634. This section of the budgeting guidance applies to the administrators of the multi-employer pension schemes:

- # PCSPS
- # NHS pensions schemes
- # Teachers pension schemes
- # Armed forces pension scheme
- # Judicial pensions scheme
- # UKAEA superannuation schemes
- # DfID overseas superannuation scheme

635. This section applies to the budgeting of the schemes themselves. It does not cover employing departments' contributions to the schemes – see Section A of this Chapter.

636. The transactions of these schemes are scored in AME. The transactions follow those that are recorded in the Resource Accounts, and are as follows:

Expenditure:

- # Current service cost (defined as “the increase in the present value of the scheme liabilities expected to arise from employee service in the current period”.)
- # Past service costs (normally expected to be zero)
- # Interest on scheme liabilities (the unwinding of the discount on the scheme liability)
- # Increase in future liability arising from employees purchase of added years and group and individual transfers in
- # There may be occasions where actual pensions benefits paid pass through the revenue account if they are not charged to a provision on the balance sheet.

Income:

- # Employers' contributions
- # Employee contributions – normal
- # Employee contributions – purchase of added years
- # Group and individual transfers in

637. Please note that there is no cost of capital credit recorded in the accounts for these schemes, and subsequently no cost of capital credit is scored in budgets either. This contrasts to bodies that run their own by analogy schemes, which do show a cost of capital credit on the liability in both accounts and budgets.

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Pension benefits payable

638. Both pension benefits payable to retired members and group and individual transfers out of the scheme that score in the accounts only on the balance sheet as a movement in cash and liabilities have no subsequent impact on the budgets. However it is necessary to score these transactions separately on COINS, and to ensure that they are balanced by an equal and opposite release of provision, so that the cash requirement can be calculated, and so that the correct information is recorded for the national accounts. Bulk transfers to the private sector need to be identified separately.
639. Where payments are not covered by an existing provision they do score as charges in Departmental Resource AME.

Section E: Bulk transfers to funded schemes

640. Where a public sector body makes a bulk transfer into a funded scheme this cash payment increases TME. Where departments are considering such payments they must contact HMT to obtain consent for the transfer. This is the case whether the transferring body has previously provided for the liability or not, or whether they have been making contributions to a public sector multi-employer scheme or not.
641. Departments should contact the Treasury early in the process of considering such transfers.

CHAPTER 14 - PRIVATE FINANCE INITIATIVE

642. The chapter sets out:
- # the objectives of the Private Finance Initiative (PFI)
 - # the accounting for PFI
 - # the budgeting for PFI separately for departments and NDPBs, PCs and NHS trusts; and separately for on and off balance sheet projects
 - # barter deals
 - # reversionary interest
 - # Termination payments
 - # the treatment of refinancing gains

PFI - Objectives

643. PFI is a means of procuring services with significant asset content. The choice of means of procurement should be driven entirely by **value for money** considerations. So:
- # PFI should be used where – and only where - it offers better value for money than other means of procurement. Departments may not use off balance sheet PFI procurement if it does not offer better value for money than conventional procurement just because a project is unaffordable within a department's Capital DEL;
 - # Similarly, own-build and other non-PFI means of procurement should be used where – and only where – they offer better value for money than PFI;
644. Departments must follow the detailed methodology laid out in the *Value for Money Guidance* (August 2004) when determining whether a prospective PFI project will be value for money.
645. In some cases, PFI deals are called **Public Private Partnerships** (PPPs). If so, they should be scored like other PFI deals. Not all PPPs are PFI deals. PPP can also be a name for certain sorts of public corporation (see separate chapter on public corporations) or private sector body (in which case the department will have an investment – see chapter on Capital DEL).

Accounting for PFI

646. The budgeting treatment for PFI projects follows the way in which they are accounted for in GAAP-based accounts. The accounting is based on two standards:
- # Whether a project is treated as a finance lease under Statement of Standard Accounting Practice 21; and

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- # Whether a project is in substance borrowing (TSB) under FRS 5. The Treasury has published a technical note providing guidance on the interpretation of FRS 5 in PFI deals.
647. If a project is either a finance lease or in substance borrowing then it is held to be on balance sheet. On balance sheet projects are in effect capital expenditure by the purchasing authority that has been financed by borrowing from the contractor. Off balance sheet projects are purchases of services by the purchasing authority from the contractor who has created an asset in order to deliver the services.
648. In the fiscal framework, on balance sheet projects:
- # Score in Public Sector Net Investment and Public Sector Net Borrowing;
 - # Will score in Public Sector Net Debt once fully reliable numbers become available to the ONS; and
 - # Score in the Maastricht general government measure of the deficit and stock of debt (the latter on the basis of estimated numbers).
649. The budgeting system reflects the distinction between on and off balance sheet projects, with technical differences in the way that the distinction impacts on:
- # Departments and NDPBs;
 - # Public corporations; and
 - # NHS Trusts.

Budgeting – Departments and NDPBs

On Balance Sheet Projects

650. On balance sheet projects score in Capital Budgets like capital expenditure undertaken directly by the department/ NDPB. The value of the capital expenditure and the timing of recognition should follow the GAAP accounting.
651. Annual repayments under the PFI contract, i.e. the unitary charge, will be treated in the Resource Budget as a mix of:
- # service charges (in budgets);
 - # repayment of the imputed loan to the private sector (outside budgets); and
 - # the full amount of interest charged on the loan
652. In addition, the resource budget will show:
- # Depreciation of the asset
 - # Cost of capital charge on the asset
 - # Cost of capital credit on the loan from the contractor

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Off Balance Sheet Projects

653. Where the project is off balance sheet the department is purchasing services. Any associated capital expenditure is an investment by the private sector and does not appear on the procuring authority's books. The only entries in the budget of the department or NDPB are the payments under the unitary charge which are payments for services and score in the Resource Budget.

Budgeting – Public Corporations

On Balance Sheet Projects

654. **PCs scored on the External Finance Basis.** For most public corporations the budgeting system scores their external finance. External finance includes Public Corporations' Market and Overseas Borrowing (PCMOB). On balance sheet PFI is a form of PCMOB and is treated in the same way:

- # The borrowing implied by on balance sheet capital expenditure of public corporations scores in the Capital Budget;
- # As the debt is amortised the capital budget of the sponsor department is credited back
- # in the calculation of the cost of capital charge to be applied in respect of public corporations, the PFI repayment liability should offset the capital base to which charges are applied; and
- # the profit that public corporations make should be calculated after the payment of the interest and service elements of service charge on the finance lease and after the deduction of depreciation on the PFI financed asset .

655. **PCs scored on the Consolidation Basis.** On balance sheet PFI would score as capital expenditure in budgets. The effects on cost of capital are as for other public corporations. The profit that scores in budgets should be calculated after the payment of the interest and service elements of service charge on the finance lease and after the deduction of depreciation on the PFI financed asset .

Off Balance Sheet Projects

656. Off balance sheet projects do not score in capital budgets and do not affect the cost of capital charge. The public corporation's payments of the unitary charge are a cost of doing business in the calculation of profits like any other purchase of services.

Budgeting – NHS Trusts

657. The budgeting of NHS trusts (England) is:

- # **On balance sheet PFI** would score as capital expenditure in budgets. In the calculation of the cost of capital charge, the outstanding PFI liability should offset the capital base to which charges are applied. The profit that scores in budgets should be

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calculated after the payment of the interest and service elements of service charge on the finance lease and after the deduction of depreciation on the PFI financed asset.

- # **Off balance sheet projects** do not score in capital budgets and do not affect the cost of capital charge. NHS trusts' payments of the unitary charge are a cost of doing business like any other purchase of services and form part of the calculation of their profits.

658. For NHS Trusts in Scotland, Wales and Northern Ireland the budgeting is the same as for departments and NDPBs.

Barter Deals

Definition of barter

659. A barter transaction is one in which party A disposes of an asset, good or service to party B; party A then receives an asset, good or service in return from party B. Money is not used as the medium of exchange, or is used for only a proportion of the transaction. Barter deals can involve the creation of financial assets and liabilities such as loans, if the goods and services are exchanged at different times.

Example of a barter deal

660. Sale and lease back deals are an example of barter deals. In this scenario a department disposes of buildings to a private sector company at no charge or at a price below the normal market value. In return the company provides the department with serviced office accommodation at below market price for a number of years. The reduction in the cash charge for service payments is a way for the department to obtain value from its asset, instead of getting the full market value in cash.

661. In effect part of the value of the building is bartered for future serviced office space. The reduction in the selling price is in effect a pre-payment of rentals. You can view this as a loan to the private sector company financed from the receipt from the disposal of the building.

662. However, this is only one example, and these general principles apply equally to barter deals that do not involve property or the PFI.

Principles of recording barter deals

663. Large barter deals should be recorded as if the exchanges had taken place in cash at current market prices. This recording applies to accounts, budgets and in the national accounts.

664. National accounts aim to score transactions at the Open Market Value (OMV). Scoring barter transactions at zero or another price would not reflect the economic substance of the transactions and misstate the balance of expenditure between sectors of the economy.

665. In the example given above, the real economic value of the asset disposed of is the OMV not nil or just the cash sum received; and the

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annual running costs should also be measured at the OMV cost of accommodation and not just the cash sum paid.

666. If the delivery of bartered assets, goods and services occur at different times it might be necessary to record a financial transaction. For example, if a department sells a building at below OMV in return for reduced future rents, there is in substance a loan from the department to the company. The reduction in the selling price is a prepayment of rents, and represented as such in the resource accounts.
667. For a barter transaction to be a viable proposition, the reduction in sale price would have to be at least equal to the net present value of the future rent reductions - using a discount rate reflecting the cost of capital of the government. So the imputed future rents have to be recorded as being equal to the cash actually paid, plus the amount being financed by the prepayment, plus an extra amount (representing a finance charge on the prepayment).

Open Market Value

668. OMV is the price of the asset, good or service that would be paid in an open market transaction without any element of barter. When assets, goods or services are bartered it is necessary to determine their OMV so that accounts can be recorded properly (i.e. using OMVs) and also for investment appraisal to ensure that the barter deal is good value for money.
669. It is for departments to determine and record OMVs.
670. Broad information for establishing OMVs should be available from information in the investment appraisal undertaken before the department decided to structure the deal in a particular way, in the supplier's bid documentation, and in the contract documentation and supporting papers.
671. For accounts, it should be assumed that the goods bartered have equal value. This means that once the OMV has been determined for the assets, goods or services supplied, the value of the assets, goods or services received in exchange will be known. For example, consider the case of a building being sold at below OMV in return for being able to pay reduced rents (i.e. at below OMV) in the future. The OMV of the building could be estimated as the cash price paid plus the net present value of the future rent reductions (using 3.5% discount rate); or the rent reductions could be estimated from the difference between the cash received and OMV of the building sold; or if both components can be estimated reliably the residual would be the implied discount rate for the financing charge. The method used should be agreed with Treasury.
672. Note that the OMV of an asset for this purpose may differ from the amount recorded in the department's balance sheet if that has not been updated recently. In such cases the difference between the balance sheet figure and OMV would be recorded in resource accounts and budgets as a loss/gain on sale. The difference between the OMV and

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the cash amount actually received as a result of the barter deal (i.e. that part of the value of the building that is bartered) would not be recorded as a loss on sale, in our example this would be shown as a prepayment.

673. For investment appraisal it is of course necessary to measure as directly as possible the OMV of all components - to identify which option is best value for money.

Budgeting for a sale and lease back deal comprising of a bartered element – off balance sheet

674. This section of the budgeting guidance assumes that accounting tests (for example SSAP21) have determined that the new rental contract is not a finance lease. If the department continues to bear most of the risks and rewards associated with ownership then this suggests that the new rental contract is in fact a finance lease and the provisions of this section of the guidance do not apply (see separate section).
675. The department's accountants must consider whether the new rental contract should be classified as a finance lease. If so, the department would record the asset on its balance sheet (because it bears the most of the risks and rewards associated with ownership).

Treatment in Resource Accounts and Budgets

676. Barter deals should be scored in departmental accounts and budgets as though they were separate transactions made at the OMV.
677. In the example above departments should record:
- # the sale of the assets at their open market value comprising;
 - ~ actual cash received, plus
 - ~ the difference between cash received and the open market value (this creates a debtor on the balance sheet - a prepayment of rentals)
 - # the full annual costs for accommodation: this has three parts
 - ~ actual cash paid
 - ~ the amount financed by the prepayment
 - ~ a capital charge on the outstanding prepayment asset
678. The profile through time of the unwinding of the prepayment will depend on the discount rate assumed and the desired profile of the imputed additions to the service charges (could be flat or perhaps increase with inflation). In the rest of the example a 3.5% discount rate is used, and the imputed additions to the service charges are constant. In other words, the sum of the loan repayment and the capital charge on the amount outstanding is constant.
679. Capital DEL scores as a benefit the book value on disposal.

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680. Resource DEL scores any difference between the OMV and the book value as profit (-) or loss (+) on disposal. In addition the Resource Budget includes the full cost as reflected in the OCS comprising.
- # actual cash paid
 - # the amount financed by the prepayment
 - # a capital charge on the outstanding prepayment asset
681. The balance sheet will show an asset (prepayment) for the difference between the cash received and the OMV of the asset as determined by the barter deal.
682. So in the example given above suppose:
- # the open market value of the building was £300m;
 - # the department sold it for a cash receipt of £200m;
 - # the department took the benefit of the remaining £100m of the value of the building by agreeing to pay cash service charge of only £42.5m in year 1 followed by 40m a year for the next four years even though the market value of the services was £64m a year – i.e. the additional imputed service charge to be recorded is £24m; and
 - # the sale took place and the receipt came in year 0 and occupation began,
 - # and rent became payable, from year 1 to 5:

Capital DEL						
Disposal of asset at NBV ¹	-320					
Resource DEL						
(Profit) / loss on disposal ¹	20					
OMV of rental		64	64	64	64	64
<i>financed by</i>						
<i>cash paid</i>		42.5	40.4	40.4	40.4	40.5
<i>prepayment</i>		18.0	19.0	20.0	21.0	22.0
<i>capital charge</i>		3.5	4.6	3.6	2.6	1.5
Value of prepayment at year end	100	82.0	63.0	43.0	22.0	0.0
cost of capital charge		3.5	4.6	3.6	2.6	1.5
NCR	-200	42.5	40.4	40.4	40.4	40.5

1. OMV = 300, NBV = 320

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Budgeting for a sale and lease back deal including a bartered element – on balance sheet

683. It is possible that the deal can be judged as on balance sheet. What follows is a recent FRAB paper on just such a scenario. The example explains the accounting and budgeting treatment.
684. Appendix 1 to this chapter shows a worked example of the accounting and budgeting for a sale and lease back deal that includes a bartered element, where the deal is on balance sheet.

Reversionary Interest

685. Some deals involve the legal transfer of the asset to the public sector at the end of the deal period. In some cases the asset will not be expected to have a value and in other cases it will. Where the asset is expected to have a value the department is said to have a reversionary interest (RI).
686. In many cases the existence of a reversionary interest will point to the public sector having the whole of the asset on its balance sheet for the life of the deal, as the public sector is taking residual value risk. In that case the reversionary interest rules are irrelevant.
687. However in some cases the deal may be judged to be off balance sheet and the department to have a reversionary interest.

Accounting and budgeting for the Reversionary Interest

688. Where a department has an RI it will build up an RI asset on its balance sheet over the life of the contract. At the end of the contract the asset will revert to the department who will debit fixed (infrastructure) assets and credit the RI asset. In other words the RI asset built up over the life of the contract will finance the acquisition of the infrastructure asset at the end of the period. The RI asset can therefore be viewed as a loan to contractor, who at the end of the period repays the loan to the department. In turn, the department uses the proceeds to purchase the asset from the contractor.
689. In order to build up the RI over the life of the contract part of the unitary payment will be capitalised. This results in a lower OCS cost and an increase in the RI asset on the balance sheet.
690. The budgets follow the accounts.
691. Capital DEL shows the following
- # movement in the RI on the balance sheet over the life of the contract, and
 - # the acquisition of the asset at the end of the period.
692. The resource budget simply shows the costs that are in the OCS, i.e.
- # the unitary payment less the amount that is capitalised as the RI.
 - # Cost of capital charge on the RI asset

Termination Payments

693. Termination payments may be payable if a PFI contract is ended early.
694. In the case of on balance sheet PFI, termination payments could represent just the extinguishment of the liability, and so not be shown in budgets, or in addition to the repayment of debt there could be a cost in budgets. That difference in treatment would depend upon the level of the balance sheet liability compared with the termination payment and what, if any, other assets come on the balance sheet.
695. Where the amount of cash paid is different to the outstanding liability, and the department is not gaining any other assets, then the national accounts treat this element of the payment (difference between liability on the balance sheet and cash paid) as a capital grant to the contractor. This is a cost (or potentially a benefit) in the departmental capital budget (DEL).
696. Where the department is receiving additional assets as part of the termination deal then it may be appropriate to capitalise the cash payment above the value of the liability. In effect the department is purchasing the additional assets from the contractor, and the price paid is the value of the cash payment above the liability that is being extinguished. Departmental budgets treat this in the same way as any other capital addition, i.e. in capital budgets (DEL).
697. Termination payments paid under off-balance sheet deals lead to a cost in the OCS / P&L and a charge to the resource budget (assuming no asset is assumed in return).
698. Any department facing a termination payment should contact your normal Treasury spending team to seek advice.

Refinancing Gains

699. This section of the guidance briefly sets the background and the policy of sharing refinancing gains on PFI deals, and details the treatment of the associated transactions in the national accounts, resource accounts and budgets. The guidance deals with the scenario where the PFI contractor goes to the private sector debt markets to refinance their debt.

Background

700. When a private sector contractor enters into a PFI deal they will borrow from the market to finance the capital expenditure they are undertaking. The market will charge the contractor a certain interest rate on that borrowing; this will be based on many things including the amount of risk perceived by the lender. The contractor will take this rate of interest into account when setting the unitary charge that is charged to the public sector for the use of the infrastructure created under the PFI contract.
701. It is common practice for the PFI contractor to refinance or restructure their debt once the project is up and running. The contractor will, at this

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point, be able to negotiate a lower interest rate, as they can demonstrate that the amount of risk has reduced.

702. The OGC has issued guidance on how departments with existing PFI contracts should be able to access these gains and split the benefit with the private sector partner (“Refinancing of Early PFI transactions”). The sharing of refinancing gains for more recent deals is laid out in the standardised PFI contract (“SoPC3”), supplemented by guidance issued by HM Treasury (“Application Note – value for Money in Refinancing”). The benefit could be in the form of either be a drop in the unitary charge or an increased level of service, or the gain may be shared via an upfront lump sum.
703. In general departments benefit in their budgets from what they can negotiate.

Refinancing

704. The contractor’s cost of providing the service drops thanks to the restructured debt profile. This is passed on to their customers (the public sector) via a reduced price to buy the service or as a one off payment.
705. Where the gain is shared via a cheaper service cost this is simply less current expenditure in the national accounts, resource accounts and resource budget over the remaining life of the contract.
706. Where the gain is shared via a one-off windfall payment to the public sector we risk distorting measures of GDP in the economy if we record this as less consumption by the public sector in one year. It is more correct to view the lump sum as a portion of the on-going savings to the contractor, which has been rolled up and then split between the parties. The view in such a situation is that the private sector has lent the public sector cash upfront and has an asset on their balance sheet, each month this would unwind to finance the reduction in the unitary charge. In effect the contractor is prepaying a reduction in the service charge.
707. This means that the refinancing gain is recorded as a benefit to the public sector matched to the time frame in which it is viewed to have accrued. A simple example ignoring any discounting is given below.
- # Public sector receives lump sum of £15m in respect of a refinancing gain, to be accounted for over 15 years, the remaining life of the contract.
 - # Suppose that the public sector continues to pay a unitary charge of £10m per annum for 15 years.
 - # The cash lump sum should be recorded as a financial transaction – in effect borrowing from the private sector. The department would show cash of £15m and a matching liability. Each year the public sector continues to pay the contractor a £10m cash unitary charge for the year.

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Accounts and Budgets

708. On receiving the cash the department shows an increase in liabilities (creditors). Then annually;
- # the OCS score £9m unitary payment, and
 - # Cash out the door would be £10m and the liability would reduce by £1m.
709. The budgets follow the accounts. In other words the upfront receipt of the cash does not benefit the resource budget, but the lower annual service charge does. The department would also receive a cost of capital credit on the outstanding liability.

APPENDIX 1 TO CHAPTER 14: SALE AND LEASEBACK

710. This appendix sets out the accounting and budgeting treatment for a sale and lease back deal including a bartered element where the deal is on balance sheet.

Background

711. 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.

712. 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.

713. 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

714. The total value of the new HQ and IT is £250 million. 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.

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	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

715. 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
-			
YEAR4	YEAR10	23.25	6 years at 23.25 = 139.5
-			
YEAR10	X029	17.25	23 years at 17.25 = 396.75
-		0.25	Balancing payment
		560	Total

Accounting for the Barter Deal – asset valuations

716. 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	Resource DEL hit with the write down of £0.3 million	Dr Revaluation reserve or OCS (FRem 5.2.34)

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	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.	Routine depreciation is reflected in non-cash	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

717. 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

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

719. The accounting entries are:

- Dr Fixed assets
- Cr Long-term lease creditor of £250m

720. The £250 million is a capital DEL hit.

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Accounting for the transfer of Plot 4

721. 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	Negative CDEL for the NBV of the transfer	Dr Prepayments (if prepayment against service / interest charges) Cr Fixed assets

Subsequent accounting

722. 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 equal to costs in the OCS, i.e. an amount 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, but note that the interest up to 3.5% and the cost of capital credit are outside budgets (these amounts are equal and opposite) As the building is on balance sheet, depreciation and the cost of capital charge on the asset also score in both the OCS and Resource DEL. The capital repayment, i.e. the movement in the long term creditor is outside of budgets.

723. 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.)

724. 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).

725. The accounting entries are:

- Dr OCS
- Cr Prepayment

The release of the prepayment has no budgetary impact – as noted it is the full OCS costs that are reflected in the budget.

Department Yellow defers the final stage of the Barter Deal

726. 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.

727. The accounting entries are:

- Dr Long-term lease creditor

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- Cr Cash
728. 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, as the cash is used to repay the creditor. (*Note: the accounting entries do not deal with Supply in respect of the net cash requirement.*)
729. During the five years of the deferral, the Department will continue to revalue and depreciate Plot 5 in the normal manner.

Final deal

730. 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.
731. The accounting entries are:
- Dr Cash
 - Cr Fixed Assets
732. There is a negative capital DEL impact in respect of the disposal of the asset.

CHAPTER 15 – END YEAR FLEXIBILITY

733. End Year Flexibility (EYF) is a mechanism whereby departments may carry forward unspent Departmental Expenditure Limit (DEL) provision into later financial years. There is no limit on the amount of unspent DEL that may be carried forward as EYF. Along with other flexibilities, EYF allows departments to manage their DEL effectively across a number of years.

Calculation of EYF

734. All expenditure and income which was classified within DEL within a particular financial year is eligible for carry forward into the following financial year if it remains unspent. This includes voted and non-voted DEL and unspent DUPs. EYF entitlements are published annually in the Public Expenditure Outturn White Paper (PEOWP).

735. Detailed guidance on the calculation of EYF is contained in the annual PES paper produced by HM Treasury for the compilation of EYF entitlements for PEOWP. However, the following arrangements usually apply:

- # any EYF entitlement generated in a particular year or accumulated from previous years but not taken up will automatically be rolled forward as part of the compilation of PEOWP;
- # departments must notify the Treasury of any changes arising from differences between, for example, Year X provisional outturn (which was used to calculate Year X+1 EYF entitlements) and final outturn. These will then be taken into account in the calculation of Year X+2 EYF entitlements.

EYF Carryover and the Reserve

736. The interaction between EYF and the DEL Reserve is as follows:

- # where, exceptionally, departments submit in-year bids to increase their DELs above the level already agreed in Departmental plans, offsetting savings from existing provision should be identified, including from any unused EYF, to avoid or minimise new claims on the DEL Reserve; and
- # if access to the Reserve is agreed and a department's DEL is increased in a particular year, the additional provision will normally be recouped from any underspending that emerges in that year or future years. This will be effected by a reduction in EYF entitlements when they are calculated for PEOWP. Capital Reserve claims would be recouped from both capital and resource underspends while resource claims will only be recouped from resource EYF.

Take-up of EYF

737. Take-up of EYF carry over is subject to normal Treasury scrutiny on the basis of need and realism.
738. For Voted spending EYF take-up will normally be effected by means of a Supplementary Estimate
739. Once the Treasury has agreed the take-up of EYF and the new level of Resource and Capital DEL, near-cash and Administration budgets Parliament needs to be told by means of a Ministerial Written Statement. Statements should be cleared in draft with HM Treasury and made at the earliest practicable time.

Separate Categories of EYF

740. When taken up, EYF may be applied to any category of expenditure subject to the following limitations:
- # **Capital DEL EYF** may only be taken up on capital programmes;
 - # Resource DEL EYF generated on programme expenditure may not be used to increase **Administration Budgets**.
 - # Resource DEL EYF generated on **non-cash expenditure** may not be taken up on **Near-Cash Resource DEL**, except as provided for under the rules for switching from non-cash to near-cash– see separate chapter.
 - # **Resource DEL EYF** – whether non-cash or near-cash, and whether administration or programme - may be **taken up in Capital Budgets** (which are not divided into non-cash and near-cash spending). Where departments wish to take up Resource DEL EYF in their Capital DEL they should convert it to Capital EYF and apply it directly as Capital DEL, and not take it up first as Resource DEL and then switch to Capital DEL.
 - # EYF generated from a **cross cutting programme** or from a programme subject to a **policy ringfence** may have restrictions on the use of the resulting entitlement agreed between the Chief Secretary and departmental Ministers. Where departments have underspends generated by such programmes they should, for each programme, consult their spending team to confirm whether any restrictions apply to take up.
741. To reflect these limitations, EYF entitlements published in PEOWP will identify separately resource DEL, within which Administration Budgets and near-cash, and capital DEL.

Cascading End Year Flexibility

742. Departments are encouraged to cascade EYF entitlements to their NDPBs and Agencies wherever practicable. Cascading ensures that the incentives EYF brings to manage resources to best effect are applied to lower level budget holders also. PES(2000)25 provides further guidance.

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743. We recognise that departments have a responsibility to keep their overall spending within the DEL, and to manage unexpected pressures. Central control of EYF along with Departmental Unallocated Provisions (DUP) gives departments a margin of flexibility to respond to changing priorities. Local underspends may arise because of shifts in demand, or overprovision, and leaving funding with local budget holders may not always give best value from the department's point of view. Moreover, claims by the department against the DEL Reserve are deducted from any departmental EYF that may emerge, so in some circumstances they cannot afford to leave full EYF with delegated budget holders. EYF policy at a departmental level should give delegated budget holders more certainty and better incentives, while recognising the need for departments to manage their DEL as a whole.
744. The first step is to give budget holders some certainty on forward year budgets. This is desirable in itself as it allows better forward planning. But it is also a good base for EYF since budget holders will tend to avoid any underspend if they fear that budget allocators will use it as a reason for giving them less money next year. So EYF entitlements should normally be considered as additions to fixed baselines in the following year. (However EYF can improve incentives even with one year budgets, since budgets are normally set before the extent of any underspend is known.)
745. There are a variety of approaches that departments can use in seeking to reconcile their own budget management requirements with greater entitlement for budget holders to EYF. For example:
- # **Full EYF entitlement with 'fines' on overspenders:** one risk that departments face is that where some budget holders spend over budget, and the underspenders have full EYF, the department's total net EYF entitlement will be less than the EYF entitlement of the underspenders. So the DEL for the following year could be at risk. One way of dealing with this is to 'fine' the overspenders by reducing their budget for the following year by an amount equal to the overspend. Careful attention needs to be paid to the cause of overspending to ensure that pressures are not just being shifted forward.
 - # **Partial EYF:** there are several variants here. Departments could allow full EYF up to some ceiling (say 5% or 10% of the budget); or carry forward of a proportion (say 50%) of any underspend.
 - # **Qualified EYF:** the department could allow 100% EYF but make clear that this be subject to review of specific cases where an underspend may be indicative of a continuing reduction in spending needs. Alternatively the department could ask for forecast underspends before the end of the financial year, and only allow carry forward of the amounts declared at that stage. This approach seeks to take account of the need for EYF to fit in with a total budgetary strategy.