

Summary Technical Guidance on the Application of the Standards used in the production of National Accounts to PFI and Similar Transactions

Introduction:

This paper sets out a brief summary of the guidance issued in the “Technical Guidance on the Application of the Standards used in the Production of National Accounts to PFI and Similar Transactions.” (“the technical guidance”)

Background to the issue:

In the past, National Accounts followed the UK GAAP compliant Resource Accounts, as UK GAAP was considered to be broadly consistent with ESA95¹ and MGDD². IFRIC 12, the IFRS standard that addresses PFI service concessions, will result in most PFI projects coming on to Department’s balance sheets for Resource Accounts purposes. However, ESA95 remains unchanged and, as such, there is an inconsistency between how PFI contracts are accounted for in Resource Accounts and how they should be accounted for in the National Accounts.

This paper describes, for simple cases, the tests that should be applied by Departments in determining whether or not PFI projects are on balance sheet for National Accounts purposes. The paper only addresses Service Concession arrangements (as defined by IFRIC 12); it does not cover leases nor does it cover user-pays arrangements. This paper should be read in conjunction with the technical guidance where a PFI project is not wholly addressed here.

The Risk Transfer Tests

Essentially UK GAAP and ESA 95 both apply a risk transfer test whereas IFRS applies a control test to determine whether or not a PFI project should be on balance sheet.

IFRIC 12 determinations should still be completed and agreed with NAO/Audit Commission for the purposes of Resource Accounting.

For National Accounts and Budgeting purposes, risk tests similar to the UK GAAP Treasury Task Force Technical Note 1 (“TTF TN1”) are applied.

MGDD states that the assets that underlie PFI and similar transactions can only be considered as being off the public sector balance sheet where there is strong evidence that the private sector is bearing most of the risk and reward attached to the asset in question. It was agreed that, for the purposes of simplicity, the determination should focus on the following three main categories of risk:

- Construction risk
- Demand risk; and
- Availability risk.

If the public sector carries the construction risk, then the assets are viewed as being on the public sector balance sheet for the purposes of the National Accounts.

Where the private sector holds construction risk, and one of demand or availability risk is transferred to the private sector, then the assets are not considered to be on the public sector balance sheet for National Accounts purposes.

¹ European System of Accounts 1995 (ESA95) – The European rules that dictate how member states should prepare their national accounts to ensure consistency of preparation across the EU.

² The Manual for Government Deficit and Debt (MGDD) - The document that further clarifies the ESA95 guidance.

The MGDD also clarifies that, as is consistent with UK GAAP TTF TN1, risks associated with ancillary services to the asset should not be considered. That is services which can commercially be separated from the provision of the underlying asset, should be excluded from the analysis. *(See section 3.2.1 of the technical guidance note for further discussion of this point.)*

Construction Risk:

Defined as: "Covers events related to the initial state of the involved asset(s). In practice it is related to events such as late delivery, non-respect of specified standards, significant additional costs, technical deficiency, and external negative effects (including environmental risk) triggering compensating payments to third parties."

On balance, have the majority of these risks been transferred to the private sector? If yes, then departments should move to consider the transfer of demand and availability risk. *(Further discussion of construction risk is included in section 3.2.3 of the technical guidance.)*

Box 2 in 3.2.5 of the technical guidance also considers how the level of Government finance provided to a PFI type project impacts on the construction risk transferred to the private sector. Where the public sector funds, lends or guarantees a majority of the cost, then the construction risk has not been transferred.

Availability Risk:

Defined as: "Covers cases where, during the operation of the asset, the responsibility of the partner is called upon, because of insufficient management (bad performance), resulting in a volume of services lower than what was commercially agreed, or in services not meeting the quality standards specified in the contract." *(Further discussion of availability risk is included in section 3.2.4 of the technical guidance.)*

Demand Risk:

Defined as: "Covers the variability of demand (higher or lower than expected when the contract was signed) irrespective of the performance of the private partner. In other words, a shift of demand cannot be directly linked to an inadequate quality of the services provided by the partner. Instead, it should result from other factors, such as the business cycle, new market trends, a change in final users' preferences, or technological obsolescence. This is part of the usual 'economic risk' borne by private entities in the market economy." *(Further discussion of demand risk is included in section 3.2.5 of the technical guidance.)*

Residual Value Risk:

This is used as a deciding factor where the 3 primary tests fail to reach a clear conclusion. *(Further discussion of the residual value risk is discussed in section 3.2.6 of the technical guidance.)*

Implications

If the project is within the scope of this guidance (i.e. is a service concession, as defined by IFRIC 12), and both construction risk and one of demand or availability risk are transferred to the private sector, then the assets underlying the service concession remain off balance sheet for **National Accounts** purposes. Accordingly, there is no impact on CDEL budgets as a result of the assets coming on balance sheet for **Resource Accounts** purposes.

If the PFI project is deemed to be on balance sheet for National Accounts purposes (as there is insufficient risk transfer to the private sector) then there will be a CDEL cost to cover the construction of the asset. You should seek the assistance of your Treasury spending team where this is the case. PES 2009 (7), issued in September 2009, describes how to record PFI type projects on the COINs system.