



MINISTRY OF DEFENCE

MOD Private Finance Unit Guidance Note Accounting for PFI projects

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This document can be found on the MOD PFU intranet-site at :

<http://defenceintranet.diiweb.r.mil.uk/DefenceIntranet/SiteTools/BusinessFinder/PrivateFinanceUnitpfu.htm>

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DOCUMENT CHANGE RECORD

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Constraints

1. This guidance note applies to all PFI projects. It supplements existing MOD and HM Treasury policy on accounting for PFI projects. This guidance should be read in conjunction with the following policy and guidance:

- (a) [JSP472 Resource Accounting Policy Manual](#);
- (b) HM Treasury document "*Technical Guidance on the Application of the Standards used in the production of National Accounts to PFI and Similar Transactions*" dated Sept 09¹.

Authoritative Guidance Summary

2. This guidance note provides advice to acquisition teams on accounting for PFI projects in plans, budgets and resource accounts. Users of this document should gain a clear understanding of the processes that acquisition teams need to follow in order to correctly report PFI expenditure in both plans/budgets and the departmental resource accounts (DRAc).

Authoritative Guidance

Background

3. In its "Consolidated budgeting guidance for 2009-10 IFRS Updated" issued on 28 April 2009, HM Treasury set out the proposed changes to the budgeting rules as a result of the move to International Financial Reporting Standards (IFRS). Essentially there is a divergence in the accounting and budgetary treatments in relation to PFI from 1 April 2009:

- Resource accounts (DRAc) follow the guidance in IFRIC 12
- Budgets will follow National Accounting standards. These standards are laid out in Part IV of the Manual on Government Deficit and Debt which provides guidance on the application of the European System of Accounts 1995 (ESA 95).

4. Under IFRIC 12 the Balance Sheet treatment is based on who has control over the use of the asset/s in question whilst under ESA 95 (as under UKGAAP) the Balance Sheet treatment is determined on the basis of which party bears most of the risk and reward attached to the asset/s in question.

¹ Copy of HMT Guidance at Annex A

5. The effect of this change is that where a PFI is controlled by the MOD within the meaning of IFRIC 12, but nonetheless passes sufficient risk transfer to the Operator under ESA95, dual reporting will be required.

6. Whilst the classification of all PFI contracts signed before 1.4.09 has been reviewed under both IFRIC 12 and ESA 95, significant contract amendments (or series of smaller ones) may fundamentally change the allocation of risk in the contract. Consequently the effect of contract amendments will also need to be reviewed under IFRIC 12 and ESA95.

Departmental Guidance

7. JSP472 Annex 03 provides detailed guidance on IFRIC 12 and PFI accounting treatments whilst HM Treasury's "Technical Guidance on the Application of the Standards used in the production of National Accounts to PFI and Similar Transactions" dated Sept 09 provides guidance on ESA95 application issues.

Revised Balance Sheet classification requirements

8. The classification under IFRIC 12 focuses on which party controls the PFI asset. If the MOD is deemed to control both the services provided by the asset and the residual interest in the asset at the end of the contract, the PFI is to be classified as On-Balance Sheet. However if no such control is established, IFRIC 4-*Determining Whether an Arrangement Contains a Lease* and IAS 17-*Leases* are to be used to both determine the existence of a lease within the PFI and, if so, whether it is a finance or operating lease.

9. The classification under ESA 95 focuses on which party to the PFI contract holds construction risk, demand risk and availability risk. If the MOD carries construction risk, the assets are viewed as being on the MOD Balance Sheet. Where the Operator holds construction risk and one of demand or availability risk, the assets are not considered to be on MOD's Balance Sheet. More detailed guidance on the application of ESA95, including a full explanation of how risk should be assessed is included in the attached *Technical Guidance on the Application of the Standards used in the production of National Accounts to PFI and Similar Transactions* issued by HM Treasury in September 2009 at Annex A.

Actions required by acquisition teams

10. Acquisition teams should determine the appropriate treatment for their PFIs for both budgeting/planning and DRAc reporting using the ESA95 guidance provided by HMT and IFRIC 12 guidance contained in JSP472.

11. Acquisition teams no longer need to engage directly with the NAO in the procurement process to agree in principle the correct Balance Sheet assessment. However, after contract signature the IFRIC 12 classification

assessment will be audited by the NAO as part of its normal audit of the Departmental Accounts.

12. MOD PFU is available to provide advice to acquisition teams having difficulty applying this guidance. Borderline ESA95 classification assessments may require approval from HM Treasury. In such instances, the MOD PFU can help the acquisition team present a case to HM Treasury.

13. The acquisition team's assessment of the Balance Sheet classification under both ESA 95 and IFRIC 12 should be referred to the DE&S (or other appropriate) Financial Accounting Team² and **must** be approved by the relevant 1* financial controller.

Planning & Budgeting

14. The Balance Sheet classification under ESA 95 is to be used for reporting PFI expenditure in Planning Rounds (PR) and Budgets.

15. Where advice has been sought from HM Treasury on the appropriate Balance Sheet classification but HM Treasury has not responded prior to PR submissions, the acquisition team's own classification should be used for inputting planning figures. If HM Treasury subsequently decides that this Balance Sheet classification is incorrect, PR figures need to be suitably amended,

On-Balance Sheet classification

16. If a PFI is assessed to be On-Balance Sheet under ESA 95, the acquisition team is required to recognise the PFI fixed assets on the MOD's Balance Sheet. The fixed assets and the corresponding liability to pay for the assets are recognised when the fixed assets are expected to come into service. The recognition of the fixed assets score against CDEL.

17. The forecast depreciation charge on the PFI fixed assets is to be reported in the PR as an OCS charge (scoring to RDEL)

18. The acquisition team needs to split the planned annual Unitary Charge figures between:

- The repayment of the liability
- The financing charge associated with the liability
- The service charge

² DE&S contact is Louise Ralph on ABW - 9679 32879 or 0306 79 32879

The financing charge and the service charge elements are to be reported as OCS expenditure (scoring to RDEL), whilst the repayment of the liability is treated as a Balance Sheet movement and therefore does not score against CTs.

Off-Balance Sheet classification

19. If a PFI is assessed to be Off-Balance Sheet under ESA 95, the acquisition team is required to report the accrued PFI Unitary Charge to the OCS (scoring to RDEL) for PR purposes. However any cash prepayments in excess of £20million and a life over 1 year need to be treated as CDEL under HM Treasury's budgeting rules.

Resource Accounts (DRAc)

20. The classification under IFRIC 12 is to be used for reporting PFI expenditure in Resource Accounts. The accounting guidance contained in Paras 16-19 above and in JSP472 should also be used when reporting PFI expenditure in the DRAc.

PFI Accounting Model

21. During IFRS implementation an Excel based model was developed by the DE&S Financial Accounting Team to assist acquisition teams with the Off to On-Balance Sheet restatement (for DRAc purposes only) of those PFI contracts signed before 1 April 2009. This model, together with detailed guidance on how to use it, is available on the DE&S Financial Accounting Team webpage to assist acquisition teams with future PFI contracts in reporting On-Balance Sheet expenditure for both plans/budgets and DRAc purposes. A worked example of the model is provided at Annex A. The model is relatively straightforward but acquisition teams should contact the DE&S Financial Accounting Team if assistance in its use is required.

Dual Reporting Requirements

22. The different IFRIC 12 and ESA95 criteria for determining the Balance Sheet classification may well lead to future signed PFIs being classified as Off-Balance Sheet for plans and budgets, whilst On-Balance Sheet for the purposes of the DRAc. New system processes have been developed by the MOD to enable the dual reporting requirement to be performed.

Further Help and Support

23. Please contact the MOD PFU and/or the DE&S Financial Accounting Team for all further help and support.

PFI ACCOUNTING MODEL & GUIDANCE

PFI Accounting Model



PFI model
Annex-R.xls

HM Treasury –

*Technical Guidance on the Application of the
Standards used in the production of National Accounts
to PFI and Similar Transactions* - dated Sept 09



Technical Guidance
on National Accounts
