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Russell Coleman
HM Treasury

Dear Russell,

1. Thank you for your letter of 17 August regarding the International Financial Reporting Interpretations Committee's (IFRIC) decision on how private sector operators of service concessions should apply International Financial Reporting Standards when they account for the transactions associated with operating a service concession. The IFRIC decision is set out in *IFRIC12 – Service Concession Arrangements*.
2. You mentioned that currently there is no directly equivalent public sector accounting guidance and that IFRS lacks a directly comparable standard to *FRS5*, the UK GAAP standard currently used to assess complex PFI-type transactions by accountants for private sector entities. You asked for ONS input into the process where HM Treasury assesses what an appropriate standard could look like for use by public sector procuring authorities.
3. You mentioned that the ONS view was being sought for the following reasons:
 - (i) domestic fiscal, and macro-economic policy more broadly, is based on key indicators drawn from the National Accounts framework, which is the responsibility of ONS;
 - (ii) the focus of the National Accounts is to describe the underlying economic substance of transactions occurring in the economy;
 - (iii) audited public sector financial statements form the basis of the public sector finances dataset;
 - (iv) the budgets of public sector entities are set so as to control public spending as measured by reference to National Accounts concepts;
 - (v) it is necessary to know for public sector budget management, prior to procurement, what the balance sheet treatment of a PPP/PFI deal will be; and

- (vi) the requirement under EU law to produce National Accounts that use internationally comparable National Accounts standards, combined with UK Government's obligation to comply with government deficit and debt thresholds as set out under legally-binding EU treaty.
4. ONS is happy to input into the process by providing details on the requirements for National Accounts. However, for clarity, it is worth recording that National Accounts and business accounting have different standards and are for different purposes. The National Accounts classification should not in itself be a factor in determining whether IFRIC12 mirror treatment is adopted in an updated *Financial Reporting Manual*.
 5. In addition to answering your questions I have, for the record, set out ONS plans for improving the recording of finance leases in the National Accounts and public sector finances. This letter has been copied to Elwyn Eilledge, Chairman of the Financial Reporting Advisory Board, and will be published on the statistics.gov.uk website.
 6. You first asked whether the approach set out in *IFRIC12* is consistent with the National Accounts principles set out in the *ESA95* international standard and the further guidance set out in Eurostat's *Manual on Government Deficit and Debt (MGDD)*.
 7. The view of ONS is that the approach is not consistent. The *ESA95* guidance is based on criteria of risks and rewards to determine economic reality rather than legal ownership, with the *MGDD* refinement similar but concentrating more on the aspect of risk and taking a once and for all judgement before the construction phase starts. The *IFRIC12* approach focuses on control over use of the infrastructure, regulation of services and entitlement to ownership at the end of the lease period. This is a different approach, although there is no certainty that the different approaches will produce different results. We note that many PFI contractors are still reviewing the potential impacts of *IFRIC12* on their reported results.
 8. Your second question asked about what may happen with the guidance in the *SNA93* international statistical manual in the future, since *SNA* is in the process of being updated. The *SNA* update is not going to immediately add guidance in this area, instead committing to doing so at a later unspecified time. International Public Sector Accounts Standards Board (IPSASB) standards may influence the eventual *SNA* direction, but the IPSASB timetable may be too slow to achieve this.
 9. However, it is the European *ESA* standards that have legal force in the EU rather than the new *SNA* standards and the implementation of a revised *ESA* will take EU Member States many years.
 10. The current UK National Accounts practice of determining the lessor/lessee in a finance lease arrangement is to use the accounting determination of the accountants/auditors responsible for the public sector entity. This is a practical approach, which enabled better estimation of General Government Gross Debt levels required under EU law and the inclusion of estimates of finance lease debt into Public Sector Net Debt. It relies on the similarity in National Accounts and business accounting of the concepts of finance and operating leases. Indeed the *MGDD* states

that "There are rules based on Generally Accepted Accounting Practice (GAAP) and on other International Standards, applied to private business to some of these arrangements. These seem to be quite consistent with the substance of ESA95 and, apart from borderline cases, they are likely to give similar results as regards the classification of assets".

11. This was a pragmatic provisional position, since the UK has over 700 PFI-type deals, many more than any other EU member state, and ONS is not resourced, nor will have the necessary information required, to carry out judgements on the recording of each of these deals. However, ONS had concerns about whether there is an impact from different accounting treatments applied in different parts of the public sector, whether there would a consistent "mirror treatment" in the partners accounting approach, and also recognised that the assumption of consistency between UK GAAP (as amended) and Eurostat guidance needed testing.
12. In this respect ONS is undertaking research on the consistency of accounting results/approaches across the economy and will be working with Eurostat early next year to analyse a small sample of PFI schemes against the *MGDD* rules. ONS is aware that the *IFRIC12* development presents a potential issue for current ONS practice as its implementation will be at odds with the above quote from the *MGDD* about the consistency in approach between GAAP and *ESA95*.

Yours sincerely,

MARTIN KELLAWAY