

IFRS: Will we count the true cost of PFIs?

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At a time when there is considerable political debate in Scotland, at both national and local government level, over the funding – or not – of future school rebuilding and refurbishment programmes via PFI schemes, it may have slipped the attention of some that there is just five months to go until an important legislative change takes place that looks set to have major implications for public sector finances in respect of those PFI contracts already in place.

Councillors and officials – and voters – should be aware that a decision announced in the Westminster Parliament by Gordon Brown in his last Budget as Chancellor of the Exchequer has major implications for UK government finances due to a potential change in the way that existing PFI schemes will be accounted for on all public sector balance sheets

What the Chancellor did was announce the adoption of International Financial Reporting Standards (IFRS) in the public sector for 2008/09 (i.e. public sector bodies accounts 1 April 2008 to 31 March 2009). To coincide with this the Treasury will, for the first time publish a set of accounts that show the financial position of the whole of the public sector in the UK based on IFRS.

Gordon Brown saw a move to IFRS as presenting an opportunity for the public sector to further improve financial reporting (listed companies currently prepare accounts using IFRS) and, in particular, to achieve better consistency in accounting for PFI schemes.

What this means for local authorities and other public sector bodies is that a whole swathe of PFI contracts looks set to be included on their balance sheet for the first time.

Let's look at some of the detail of what is involved:

Under a PFI contract the private sector is responsible for supplying services that were traditionally provided by the public sector. In a PFI contract the private sector operator designs, builds, finances and operates the property as part of a service contract. The current accounting treatment of whether the property is on or off the public sector balance sheet depends on an assessment of where the risks and rewards lie i.e. with the public sector body or the private sector operator. As a result, different contracts have different accounting treatments; for example, a lot of transport infrastructure PFI's remain on the public sector balance sheet whereas most hospital PFI's are not.

In July 2007 HM Treasury reported that in Scotland there were signed PFI projects with over £3.9 billion of capital value off the public sector's balance sheet (the equivalent to 19 Edinburgh Royal Infirmary hospitals). Across the UK as a whole PFI agreements with a capital value of £30 billion are not included on the public sector balance sheet. These capital values also bring an associated level of debt with them, albeit that the value of debt will not necessarily equate to the capital value of PFI schemes

Moving to IFRS in 2008/09 will mean re-evaluating whether these contracts should be off the public sector balance sheet. The IFRS relevant guidance does not formally address the public sector (grantor) side of accounting for such contracts, but it does state that the property in any such arrangement should not be classified as a fixed asset on the operator's balance sheet. As a fixed asset has been created e.g. school, hospital, then it must be recorded somewhere, which has led most commentators to believe that it will, therefore, be shown on the public body's balance sheet.

Currently HM Treasury are considering the guidance and hope to arrive at a definitive agreed position by the end of the calendar year.

The problem for the Treasury is that bringing these assets onto the public sector's balance sheet means that the debt associated with the contract - i.e. the commitment to pay the private sector over a period often spanning decades - is also brought onto the balance sheet. At the moment the Treasury believes about 54% of PFI liabilities are off balance sheet. Bringing them on is likely to break Gordon Brown's own sustainable investment rule i.e. that public sector debt is maintained below 40% of Gross Domestic Product in each and every year of the economic cycle.

Optimistic observers regard the adoption of IFRS as an opportunity for Government to redefine how it interprets this fiscal rule.

In my view, it is imperative that proper accepted accounting should be the driver here. Avoiding breaking a fiscal rule that many people consider flawed anyway is of secondary importance

Now is the time to finally agree a consistent and acceptable approach to PFI accounting. This will allow public sector bodies to make real comparisons and decisions regarding value for money and affordability in capital financing decisions.