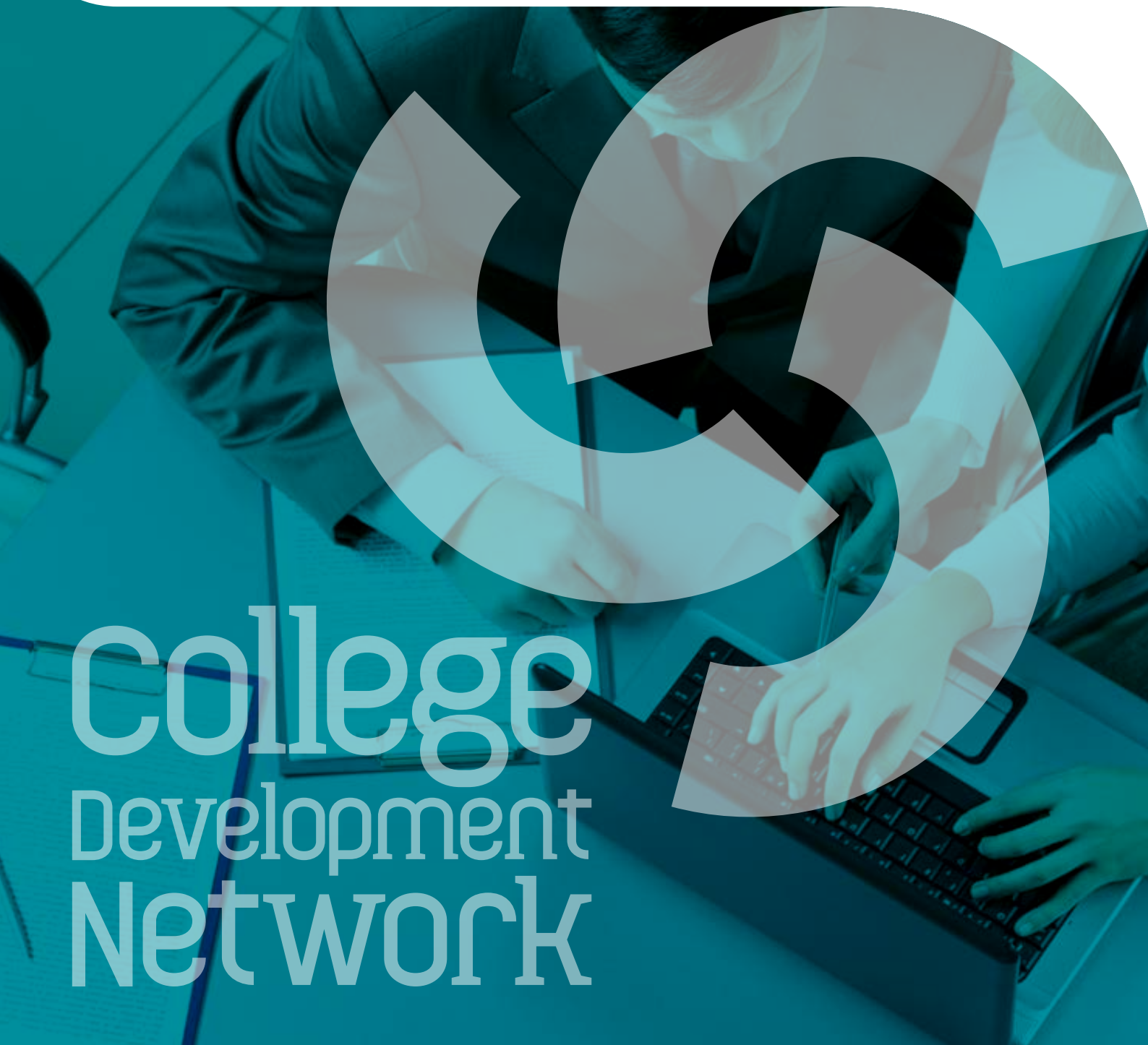
College Development Network

Finance CoP

Briefing Paper

Accounting for Private Finance Initiative (PFI) schemes under IFRS within the Further Education Sector

May 2013



Accounting for Private Finance Initiative (PFI) schemes under IFRS within the Further Education Sector

Introduction

The current SORP, Accounting for Further and Higher Education (July 2007) (FE SORP), requires compliance with UK Generally Agreed Accounting Practice (UK GAAP). This paper considers the potential impact of the Accounting Standards Board's (ASB'S) proposal for converging UK GAAP with International Financial Reporting Standards (IFRS). Specifically, it considers the impact of accounting for Private Finance Initiatives (PFI) schemes and similar contracts on the adoption of IFRS.

Background to IFRS adoption

The Accounting Standards Board continues to meet regularly to discuss and address the comments received on FRED 43 'Application of financial reporting standards' and FRED 44 'Financial reporting standard for medium-sized entities (FRSME)'. These two standards, together with FRED 45 'Financial Reporting Standard for Public Benefit Entities (FRSPBE)', set out a proposed IFRS-based framework for UK GAAP. The comment period for FRED 45 closed on 31 July 2011. Going forward, a separate Further and Higher Education SORP is expected to be retained, updated based on the final FRSME and the FRSPBE.

The ASB has taken tentative decisions:

- To defer the effective date to 1 January 2014. For Colleges with a year-end of 31 July (or March), the first full year of adoption will be 2014/15 with a restated opening balance sheet required as at 1 August 2013;
- To change the principles for amending the IFRS for SMEs to permit or require accounting options that align with EU-adopted IFRS, for example revaluation of property, plant and equipment;
- To specifically refer to SORPs in the FRSME (in relation to selection of an accounting policy);
- To amend the draft FRSME to meet required formats under Company law;
- To remove the requirement for publicly accountable entities to prepare accounts under EU-adopted IFRS. This means the application of EU-adopted IFRS will not be extended beyond the current requirements in law and consequently the scope of the FRSME will be expanded in certain areas; and,
- To retain a reduced disclosure framework for all qualifying subsidiaries (with one exception for subsidiaries which are financial institutions) and to require these entities to follow the relevant SORP. For the College sector the options therefore are either:

Tier 1 Full EU- adopted IFRS	Tier 2 FRSME
Applies as required in law (eg listed entities) Entities may choose to adopt full IFRS FRSPBE is guidance Follow SORP	All other entities FRSPBE is mandatory Follow SORP
Subsidiaries apply reduced disclosures	Subsidiaries apply reduced disclosures

What is a PFI/PPP contract?

A Private Finance Initiative (PFI) contract is one where usually a public sector entity (the purchaser) acquires capital and operating services from a private sector entity (the operator) for a return. Traditionally under a PFI contract the private sector entity is responsible for providing services which would have been provided by the public sector. This allows the experience of the private sector entity to be drawn upon to provide the service. It is integral to most PFI contracts that the operator designs, builds, finances and operates a property in order to provide the contracted service.

A public- private partnership (PPP) contract describes a specific PFI agreement government service or private business venture which is funded and operated through a partnership of government and one or more private sector company.

Main Features

A contract to provide services is awarded by the purchaser to the operator. The contract will specify the level of service required over the period of the contract. The PFI contract will specify arrangements for the property at the end of the contract term (which may include various options available to both parties), and determine the accounting treatment of the property during the contract term.
Under general accounting principles one party will have an asset of the property, where that party has access to the benefits of the property and exposure to the risks inherent in those benefits. If that party is the purchaser, and in most cases in the FE sector it will be, it will have a corresponding liability to pay the operator for the property.

It is often the nature of a PFI contract that this will include post construction services relating to the ongoing management of the property. For accounting purposes, these service delivery charges are considered separately and charged through the comprehensive income statement.

Accounting for PFI schemes from the operator's viewpoint can be very complicated and there is often trepidation amongst accountants in this regard. The accounting treatment adopted by the purchaser is however significantly simpler. Indeed, that adopted under IFRS is not dissimilar to that currently adopted under UK GAAP.

Accounting for PFI/PPP Transactions: (FRS5, Application Note F 'Private Finance Initiative and Similar Contracts') / IFRIC 12 'Service Concession Agreements'

Currently the FE SORP adopts FRS 5 including Application Note F, *Private Finance Initiatives and Similar Contracts.* It is considered that the accounting treatment of this type of transaction is likely to be relevant to institutions which have entered into PFI or PPP arrangements for student accommodation or other estate management initiatives. In particular, this application note provides guidance on which party's balance sheet the assets used to fulfil PFI contracts should be included.

IFRIC 12, is an interpretation of the application of IFRS for service concession agreements, issued by the IFRS Interpretations Committee (formerly IFRIC). This represents the closest IFRS equivalent to Application Note F of FRS 5. It applies to contractual arrangements whereby a private sector operator participates in the development, financing, operation and maintenance of infrastructure for public services, as in under PFI contracts.

It is noted however that IFRIC 12 specifically deals with the accounting treatment to be adopted by the operator (the contract provider) and not the public benefit entity, i.e. the FE College. There is no direct equivalent to FRS 5 with regards to the accounting treatment to be adopted by the public benefit entity. That considered, from the College's point of view it is fair to assume that the accounting treatment to be adopted should maintain symmetry with that adopted by the operator.

Tests for application of IFRIC 12 under IFRS accounting

The IFRIC applies to service concessions where both of the following apply:

- The FE College controls or regulates what services the operator must provide with the property, to whom it must provide them, and at what price; and
- The FE College controls through ownership, beneficial entitlement or otherwise – any residual interest in the property at the end of the contract.

In practice, control or regulation is generally evidenced by agreement of both parties to contractual terms setting out service delivery requirements and associated cost.

In such scenarios, the service provider is not permitted to recognise a tangible fixed asset of the property on the balance sheet and instead must recognise either a financial asset (a current asset) or an intangible asset.

It is common for the public entity in question to control the operator's use of the asset through the contract. Additionally the specialised nature of many PFI assets means that frequently they will transfer to the public entity at the end of the contract. In general the answer to both of the above tests is 'yes' and consequently the public benefit entity will need to recognise the tangible fixed asset 'on balance sheet'.

Schemes where a public benefit entity has an option to purchase the asset which cannot be rejected by the service provider would again result in the public benefit entity accounting for the scheme 'on balance sheet'. This would involve recognition of the asset within property, plant and equipment along with a corresponding lease liability.

The above treatment assumes the option to buy will be taken up by the College. This is likely to always be the case, however if it were known not to be, the comprehensive income statement would be charged with the full cost of each payment as if the agreement were an operating lease.

Accounting Treatment

Based on the above, the principles under IFRS are the same as currently adopted under UK GAAP whereby:

- The asset and associated liability to pay for it should be recorded in the FE Colleges balance sheet at fair value of the property;
- The asset should then be depreciated in the normal manner, and the liability reduced by payments made annually to reduce the capital outstanding; and,
- The remainder of the PFI payments made to the operator for services provided (after stripping out finance charges associated with the capital) should be recorded through the statement of comprehensive income (income and expenditure account) as in a normal operating lease payment akin to the treatment adopted under UK GAAP, SSAP 21 *'Accounting for leases and hire purchase contracts'*

Conclusion

The accounting treatment to be adopted with regards to a PFI contract, under IFRS, will ultimately be determined by reference to the contract and assessment of where the risks and rewards of ownership lie. This will determine which party can recognise the asset on balance sheet.
Based on the interpretation above there is no significant difference from the FE Colleges point of view, as the purchaser, to the accounting treatment adopted with regards to PFI contracts under IFRS from that which is used for UK GAAP: when the risks and rewards lie with them the asset is brought on balance sheet.

College Development Network is a trading name of the Scottish Further Education Unit.

Scottish Further Education Unit | Company Limited By Guarantee | Registered in Scotland No: 143514 | Scottish Charity No. SC021876 | VAT No. 617148346

Tel: 01786 892000 E-mail: info@collegedevelopmentnetwork.ac.uk Web: www.collegedevelopmentnetwork.ac.uk