

FINAL PFI TEXT

Accounting for PPP arrangements, including PFI contracts, under IFRS

Scope

6.2.28 This section of the Manual deals with the accounting treatment of PPP arrangements, including PFI contracts, that meet the definition of service concession arrangements in IFRIC 12 *Service Concession Arrangements*. To be within the scope of IFRIC 12, the service concession arrangement must contractually oblige the private sector operator to provide the services related to the infrastructure to the public on behalf of the grantor (the public sector) (IFRIC 12.3). Contracts that do not involve the transfer or creation of an infrastructure asset for the purpose of the contract fall outside the scope of IFRIC 12, as do arrangements that do not involve the delivery of services to the public¹. Examples of infrastructure for public services - are: roads, bridges, tunnels, prisons, hospitals, airports, water distribution facilities, telecommunication networks, permanent installations for military etc. operations, and non-current assets used for administrative purposes in delivering services to the public².

6.2.29 The private sector operator will apply IFRIC 12 to those arrangements where:

- a) the grantor controls or regulates what services the operator must provide with the infrastructure, to whom it must provide them and at what price; and
- b) the grantor controls – through beneficial entitlement or otherwise – any significant residual interest in the infrastructure at the end of the term of the arrangement.

Where the infrastructure asset is used for its entire useful life, and there is little or no residual interest, the arrangement would fall within the scope of IFRIC 12 where the grantor controls or regulates the services as described in the first condition (see also IFRIC 12.6). Significant residual interest will exist where the grantor is contractually required to purchase the infrastructure asset at the end of the term of the arrangement.

6.2.30 IFRIC 12 (Application Guidance paragraph 3) notes that, in determining the applicability of the first condition, non-substantive features (such as price capping that would apply only in remote circumstances) should be ignored and the substance of the arrangement considered.

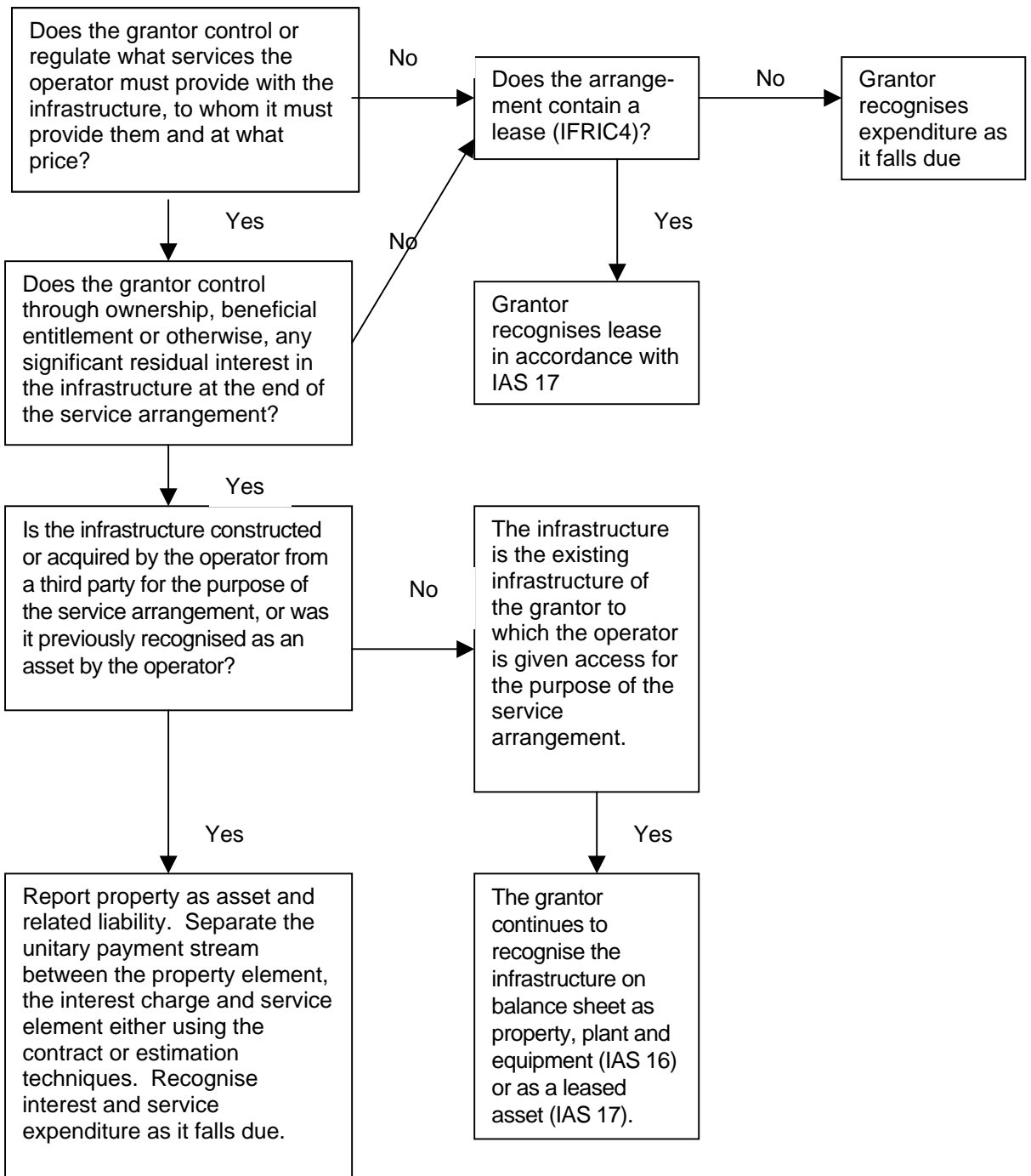
6.2.31 IFRIC 12, including the Appendices, Information Notes, Illustrative Examples and Basis for Conclusions, provides guidance on how to apply IFRS to service concession arrangements. IFRIC 12 does not create exceptions from other IFRS for transactions that are within service concession arrangements, other than as specifically stated in IFRIC 12. Issues not addressed explicitly in this section of the Manual should be resolved by reference to other IFRS. IFRIC 12 applies to:

¹ Services might be delivered directly to the public (the road network, for example) or indirectly (non-current assets held for administrative purposes in the delivery of services to the public).

² This list of examples is not exhaustive.

- arrangements where the infrastructure is used for its entire useful life;
- infrastructure that the operator constructs or acquires from a third party; and
- infrastructure that the grantor provides to the operator for the purpose of the concession.

IFRIC 12 does not specify the accounting for infrastructure that was held and recognised as an asset by the operator prior to entering the arrangement (IFRIC 12.6-8). This is because the operator would de-recognise the asset under IAS 16. Paragraph 6.2.32 interprets IFRIC 12 for the public sector by including an asset previously owned by the operator within the criteria for recognising the arrangement as a service concession. The flowchart overleaf will assist in determining the appropriate accounting treatment of PPP arrangements, including PFI contracts by public sector grantors.



Initial recognition and measurement of assets and liabilities in new arrangements and contracts

6.2.32 Where there is infrastructure, whether previously owned by the contractor or the grantor, or constructed or acquired from a third party for the purpose of the service arrangement, and the grantor controls:

- a) or regulates what services the operator must provide with the infrastructure, to whom it must provide them and at what price; and
- b) through beneficial entitlement or otherwise, any significant residual interest in the infrastructure at the end of the term of the arrangement (or there is no residual interest);

then the PPP arrangement or PFI contract is a service concession within the meaning of IFRIC 12 from the grantor's viewpoint.

6.2.33 The grantor should recognise the infrastructure as a non-current asset and value it in the same way as other non-current assets of that generic type. The asset will be recognised when:

- a) it is probable that future economic benefits associated with the asset will flow to the organisation; and
- b) the cost of the asset can be measured reliably.

In practice, this means that the grantor will usually only recognise the asset when the asset comes into use. Where the grantor makes contributions to the operator in advance of the asset coming into use, the grantor should account for those payments as prepayments.

6.2.34 The asset will be measured in one of two ways:

- a) where the contract is separable between the service element, the interest charge and the infrastructure asset (see also paragraph 6.2.35), the asset will be measured as under IAS 17, with the service element and the interest charge recognised as incurred over the term of the concession arrangement; or
- b) where there is a unitary payment stream that includes infrastructure and service elements that cannot be separated, the various elements will be separated using estimation techniques as set out in paragraph 6.2.36.

6.2.35 The grantor should separate out the service, interest and infrastructure elements. A contract may be separable in a variety of circumstances, including but not limited to the following.

- a) the contract identifies an element of a payment stream that varies according to the availability of the property itself and another element that varies according to usage or performance of certain services;

- b) different parts of the contract run for different periods or can be terminated separately. For example, an individual service element can be terminated without affecting the continuation of the rest of the contract; or
- c) different parts of the contract can be renegotiated separately. For example, a service element is market tested and some or all of the cost increases or reductions are passed on to the grantor in such a way that the part of the payment by the grantor that relates specifically to that service can be identified.

6.2.36 In situations where it is not possible to separate the contract due to commercial reality, then the service element of the payment must be estimated, which could be achieved by obtaining information from the operator or using the fair value approach. The fair value of the asset determines the amount to be recorded as an asset with an offsetting contract liability payable. The total unitary payment is then divided into three: repayment of the capital element of the contract obligation and the interest expense on it (using the interest rate implicit in the contract), with the remainder deemed to relate to the service charge.

6.2.37 In determining the interest rate implicit in the contract, a reporting entity should use the risk-free market rate at the time the contract was signed. The rate should not be changed unless the infrastructure element or the whole of the contract is renegotiated. The risk-free rate should be determined by reference to the UK long-term real interest rates as published in the spreadsheet on this manual's dedicated website. Column 4 of the spreadsheet gives monthly long-term real rates from January 1996 to April 2008. For each month thereafter, the rate should be calculated by adjusting the UK's long-term nominal interest rate (found in table 26 of HM Treasury's Pocket Data Bank) by the UK inflation rate (table 16 of HM Treasury's Pocket Data Bank). There is a link to the Data Bank on this manual's dedicated website.

6.2.38 Under either approach, the grantor will recognise a liability for the capital value of the contract. That liability does not include the interest charge and service elements, which are expensed annually to the Operating Cost Statement.

Initial recognition of existing arrangements which were off-balance sheet under UK GAAP

6.2.39 On initial recognition of existing PPP arrangements or PFI contracts under this approach (that is, those arrangements or contracts that had previously been off-balance sheet), reporting entities should measure the non-current asset at the opening balance sheet date in the same way as other non-current assets of that generic type. The liability should be measured at its fair value at the balance sheet date, which will normally be the outstanding liability in respect of the property (that is, excluding the interest and service elements), discounted by the interest rate implicit in the contract.

Subsequent measurement

6.2.40 Reporting entities should adopt an appropriate asset revaluation approach as set out earlier in this chapter. Liabilities will be measured using the appropriate discount rate, taking account of the reduction arising from the capital payments included in the unitary payment stream.

Income generated by the grantor from the service concession arrangements

- 6.2.41 Revenue received under any revenue sharing provision in the service concession arrangement should be recognised when all the conditions as laid down in IAS 18 have been satisfied.

Consideration given by the grantor to the operator (guarantees made by the grantor as part of the arrangement)

- 6.2.42 The grantor should recognise any guarantees to the operator that it will meet any shortfalls in revenue or repay the debt if the operator defaults in line with the requirements of IAS 32 and IAS 39. Additional guidance on accounting for financial instruments is available on the Manual's dedicated website.

Items provided to the operator by the grantor

- 6.2.43 The grantor should derecognise a non-current asset provided to the operator (and not used in the arrangement) and recognise any consideration received at fair value. If the consideration received is in the form of a reduction in future payments, this should be recognised as an asset representing a reduction in the future liability (normally as a prepayment).

Disclosure

- 6.2.44 The disclosure requirements in respect of PPP arrangements, including PFI contracts, are set out in chapter 5 of this manual.