HM Treasury

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DAO(GEN) 16/99

8 October 1999

Dear Accounting Officer,

ACCOUNTING FOR PFI: IMPLEMENTATION

Purpose of this DAO

DAO(GEN)12/99 attached a copy of Technical Note No.1 (Revised) *How to Account for PFI Transactions*. The DAO indicated that the revised note was applicable to transactions accounted for in financial years ending on or after 10 September 1998. This letter attaches some further guidance on implementation.

Information

2. The Treasury has recently issued a paper *Accounting for Private Finance Initiative (PFI): Effect on DEL* (PES(99)24). This set out how departments and other public bodies should review their existing and future PFI projects to see if a change in accounting treatment was needed to accord with Technical Note No.1 (Revised), and set out a timetable for the review. The relevant paragraphs are annexed to this letter.

3. The remainder of the PES paper, not attached, was the budgeting guidance promised in the earlier DAO letter (paragraph 5) directed specifically at departments and advising them of the consequential action to change their DEL (Departmental Expenditure Limit) numbers.

Action by departments and other public bodies

4. The guidance in the annex is mandatory for all bodies preparing their financial statements in accordance with the Resource Accounting Manual, and for NDPBs, trading funds, NHS trusts and those public corporations preparing financial statements in accordance with an Accounts Direction issued or approved by the Treasury.

5. Departments should send copies of this letter to sponsored bodies to enable them to take suitable action.

Enquiries

6. Any questions to the Treasury should be addressed in the first instance to Tracy Gordon in the Central Accountancy team (0171-270-4538) or Alastair Campbell in the Private Finance Policy team (0171-270-5022).

7. Further copies of Technical Note Number 1 (revised) may be obtained from the Treasury's Public Enquiry Unit (0171-270-4860) and of the earlier covering DAO from Mangai Rajasingham in the Treasury Officer of Accounts Team (0171-270 4313).

JAMIE MORTIMER

ANNEX

ACCOUNTING FOR PFI: IMPLEMENTATION

The guidance in the following paragraphs is mandatory for all bodies preparing their financial statements in accordance with the Resource Accounting Manual, and for NDPBs, trading funds, NHS trusts and those public corporations preparing financial statements in accordance with an Accounts Direction issued or approved by the Treasury.

2. **Inclusion in Accounts.** Normally, a project will affect accounts - and hence budget outturn or plans - from the year in which it becomes operational, not the year in which the contract is signed. The only exception to this rule is where the construction risk of a project is retained by the purchaser, in which case the expenditure should be recognised in the accounts as the asset is constructed.

3. **Consulting External Auditors**. Where departments or other public bodies have any uncertainty in respect of the appropriate accounting treatment for specific schemes, they are advised to discuss the schemes with their external auditors. That way, departments can establish whether their auditors would be likely to view their proposed accounting treatment as reasonable given likely project design and contract terms. Auditors should be contacted as follows:

For existing PFI contracts: Establish whether auditors believe that the present accounting treatment is still appropriate and discuss the extent of review each existing PFI scheme requires. If auditors accept that the accounting treatment of specific contracts is not material to the accounts of the individual reporting body giving a true and fair view then they may agree that no further review is required;

For all PFI projects in an advanced state of procurement (Invitation to Negotiate (ITN) issued by 1 October 1999): Establish with the auditors whether the currently envisaged accounting treatment is likely still to be appropriate, and what depth of review is needed to establish the right treatment; and

For all new PFI contracts as they are negotiated: Consult the auditors prior to issue of ITN and during contract negotiations as appropriate. Guidance on the extent of consultation is provided in Treasury Taskforce Technical Note Number 1 (Revised) - *How to account for PFI transactions* and in PES(96)30*.

4. In view of the number of existing contracts and those which are already under negotiation, the Treasury Task Force have passed on some initial comments from the NAO to departmental PFU heads indicating the extent of review the NAO considers appropriate for existing schemes.

5. **Timetable for reviewing the accounting treatment of contracts**. The timetable below applies both to PFI contracts already let and to those which are reaching one of the stages in negotiation at which auditors should be consulted (see "Implementation" section below):

by December 1999, for all projects which are or may become operational or might affect budget outturn or plans for years up to end of 2001-02 (so that revised numbers can be put into the PES database before the start of the 2000 Public Spending Review);

* *Public Expenditure Treatment of Finance Leases and Transactions that are in Substance Borrowing* 20 December 1996

by January 2000, for all projects that may become operational or affect plans for forward budgets for the remaining years of the 2000 Public Spending Review, ie 2002-03 and 2003-04, so that departments will be aware of them during that Review; and

#	**soon after**, for all projects that would not become operational or affect plans before 2004-05.

6.	Public bodies which are not audited by NAO should seek to agree a broadly similar timetable with their auditors.

7.	**Process.** Drawing on work it commissioned earlier, the Treasury has circulated** to departments a methodology that might be developed further by departments and their advisers as the basis for consistent reporting and an accounting analysis report form that should be used where a classification change is requested or assistance is being sought from the Taskforce.

8.	**Implementation of changes to financial statements.** The implementation depends on when PFI contracts become operational (or come into financial statements because of construction risk):

#	*For PFI contracts which were operational in 1998-99.* If financial statements for 1998-99 had already been signed-off before the circulation of DAO(GEN) 12/99, no further action need be taken on the 1998-99 statements in -respect of Technical Note No.1 (Revised) . If statements are not yet signed-off, departments and other public bodies should discuss with their auditors whether it is feasible to review the accounts for the 1998-99 statements before sign-off (ie so statements are still signed-off within the timescale Parliament would expect). Where signed-off statements were not able to take account of the Technical Note, if a contract is material to the accounts for either 1998-99 or 1999-00, the figures for 1998-99 may need to be re-stated in the statements for 1999-2000. Restatement will be necessary where the previous accounting treatment of the contract needs to be changed to accord with Technical Note No.1 (Revised).

#	*For PFI contracts already let, but not operational until 1999-00 or later.* The accounting treatment of all contracts material to the accounts should accord with Technical Note No.1 (Revised).

#	*For new PFI contracts as they are negotiated.* The auditors should be consulted on the accounting treatment prior to issue of the ITN, and during contract negotiations as appropriate - see the stages indicated in paragraphs 2.1-2.2 of Technical Note No.1 (Revised). Where the early stages of negotiation were measured on the basis of the interim guidance, information and supporting documentation in the later stages will need to take account of Technical Note No.1 (Revised).

9.	**Status of Auditor's Advice.** Departments and other public bodies should note that advice from an auditor before or during the course of the procurement process would not guarantee their eventual accounting opinion, and it would state that it was subject to any alteration or discovery of fact or circumstances of the transaction as it is negotiated through to completion, or in subsequent audit of financial statements. Giving such advice should not compromise the auditor's final audit opinion, as the auditor would be expected to reach the same conclusion with the same set of facts and circumstances. It is for the responsible Finance Officer to judge if there is a material change of fact or circumstances sufficient to seek an update of advice already received.

**	Appendix iii of *Accounting for PFI: Retrospective Application Of Technical Note No1 (Revised)*. From Tim Wilson, Head, Private Finance Policy Team, Private Finance Taskforce, HM Treasury, to all Heads of PFUs, September 1999. This provided experience gained in applying the Technical Note to a sample of six projects. (Other parts of the September paper are no longer relevant.)