



Financial Reporting Advisory Board Paper

'On-On' and 'Off-Off' balance sheet PFI/PPP capital assets – Issue and Recommendations - Office for National Statistics

Issue:	<p>ONS measures the UK economy, through the National Accounts, following an internationally accepted framework that relies upon a balanced set of accounts for the whole economy and by sector with a counterpart liability for every asset. ONS must therefore avoid double-counting or omission of any economic activity, transaction or asset.</p> <p>In GAAP accounting capital assets constructed or improved under PFI or PPP projects could be scored as both on the private and public entity's balance sheet (known as 'on-on') or on neither (known as 'off-off').</p> <p>In National Accounts this should not happen. This potential double counting or omission is an issue for ONS and should be seen as an issue for the Government and the accounting community.</p>
Impact on guidance:	Potential changes to the HM Treasury Technical Note (TN) and/or Application Note F, Amendment to FRS5 (AN) to achieve greater consistency and less ambiguity between the two documents.
IAS/IFRS adaptation?	N/A
IPSAS compliant?	N/A
Interpretation for the public sector context?	N/A
Impact on budgetary regime?	No
Alignment with National Accounts	N/A
Impact on Estimates?	N/A
Recommendation:	FRAB members are asked to confirm that the issues as stated

accurately reflect the position and the proposals for moving forward cover the main options. Advice and direction from the FRAB members, particularly on the applicability of the proposals, is also sought.

Timing: Not known at this stage.

DETAIL

Background and the potential problem

1. This paper details the issue and proposes a way forward. In this respect it provides an update to FRAB about how ONS has assessed the issue following completion of its work to include imputed public sector finance lease liabilities in public sector net debt. This paper does not and cannot provide a clear indication of what ONS will do and by when. This can only come after further discussion and debate and a consideration by ONS of its priorities.
2. ONS measures the UK economy, through the National Accounts, following an internationally accepted framework that relies upon a balanced set of accounts for the whole economy and by sector with a counterpart liability for every asset. ONS must therefore avoid double-counting or omission of any economic activity, transaction or asset.
3. In GAAP accounting capital assets constructed or improved under PFI or PPP projects could in practice be scored as both on the private and public entity's balance sheet (known as 'on-on') or on neither (known as 'off-off'). In National Accounts this should not happen. This potential double counting or omission is an issue for ONS and should be seen as an issue for the Government and the accounting community.

Reasons for the potential problem

4. GAAP accountants make judgements about whether the entity they account for is the (economic) owner of the majority of the risks and rewards of the capital asset separately and independently from the accountants who make judgements for the other party to the PFI or PPP (e.g. a government department). As a consequence both accountants might make conclusions or judgements that appear inconsistent.
5. PFI and PPP projects can be complicated with several new assets being created or improved/developed and various elements of construction and service delivery. Several private companies might be involved through the life of the project. These contracts can also be long lasting (contracts often last for 30 years). It is therefore not always straightforward for accountants to determine if the partner they represent bears the majority of the risks and rewards of ownership for the capital asset(s).
6. Different accounting guidance documents are available to help accountants base their decisions. However, it has been argued that interpretation of these guidance documents is not always

straightforward or unambiguous. These documents include Application Note F, Amendment to FRS5 (AN) and Technical Note 1: How to Account for PFI Transactions, HM Treasury (TN). FRAB has previously seen papers on this issue, focussed on assessing the differing guidance and inconsistencies between these two documents and the chances of different conclusions being reached by the accountants applying them (see FRAB paper (80) 04, 29 June 2006) (paper attached).

7. National Accountants face a number of issues with this problem. Not only do the GAAP accounting guidance documents provide confusing advice, but neither of the main National Accounts manuals (The United Nations System of National Accounts (1993) and the European System of Accounts (1995)) provide specific guidance on the accounting treatment of PPP or PFI project assets. Some guidance is available in Eurostat's 'Manual on Government Deficit and Debt'. However, this manual offers an alternative approach to the assessment of economic ownership compared with the AN and the TN. Essentially, the aim of both is to help determine if an entity holds the majority of the risks and rewards of ownership of an asset, but there are differences as to precisely how this is to be done.

Difficulties assessing the size of the potential problem

8. The first step is to assess the magnitude of the problem. To achieve this complete information about how both the partners have accounted for the capital assets under PFI and PPP projects is needed. Complete information is not currently available.

9. For the public sector, following ONS and HM Treasury work during 2006 ('Phase I' of the ONS project) information about capital assets that have been judged to be on public sector entities balance sheets is available. ONS has accepted the judgements of the accountants here in producing these estimates. However, these assets may potentially also have been scored as on the private partner's balance sheets and hence there may be 'on-on' assets. To determine if this has happened, the private sector partner, specifically the Special Purpose Vehicle (SPV), must be identified and its responses to ONS surveys (if available) or its accounts, assessed. Unfortunately, there is no comprehensive list of SPVs and the PFI/PPP projects with which they are associated so this task is made more complicated.

10. Capital assets under PFI and PPP projects scored as off the public sector entities balance sheet will be identifiable, by deduction, from the Phase I work. Again, the lack of a comprehensive list of SPVs makes it difficult to do a complete check of the private partners' data or accounts to ascertain if the capital asset has been scored on their balance sheet. If this check were possible with the available data and it was found in some cases that the private sector partner had not scored the capital assets on its balance sheet then there would be 'off-off' assets.

11. Even if a comprehensive list of SPVs existed or could be compiled, all the issues would not be resolved. It is possible that not all SPVs are currently sampled through capital expenditure surveys at ONS. This is because ONS generally only sends its survey questionnaires to samples of the business population due to a need to keep the burden on private companies to a minimum and to maintain reasonable costs. Only larger companies selected by numbers of employees, are routinely sampled under normal practices. Smaller companies, by employment, are randomly selected and

there are restrictions as to how many surveys and for how long these companies can be included. By their nature SPVs often have very few employees. Therefore, normal ONS practices of sampling and surveying could miss some SPVs.

12. ONS attempts to avoid this problem of missing SPVs, with low employment, but high turnover and capital expenditure, by adjusting its samples to include these SPVs when they are known. Construction news, other media and data sources (e.g. registers surveys and construction statistics) are used to inform this process. However, without a full list of SPVs, ONS cannot be certain that it has captured all SPVs for the relevant surveys if indeed this were considered the correct approach for collecting such information, which is debatable. It is perhaps more appropriate for the data for these projects to come from the public sector side, if this is available.

13. As stated above, ONS surveys are generally sent to a sample of businesses. These samples are selected from the ONS Inter-departmental Business Register (IDBR). Complications exist when trying to sample SPVs, not least because there is no complete list, but also because it is difficult to classify SPVs. The SPV is a consortium of various companies and its primary activity is likely to change through the life of the project as the work progresses through construction to service delivery. It may not always be clear if the industrial classification of the company should be construction or under business services or another.

What is needed? (Proposals for moving forward)

14. Complete information about the accounting treatment of assets constructed or improved/developed under PPP and PFI projects for the private partner for all deals in the UK. ONS will need help from the public partners to collect this information.

15. A full list of SPVs involved in all projects with details about the primary industry to which the SPV should be classified. ONS will need assistance from government departments including HM Treasury to achieve this.

16. Once the size of the 'on-on' and 'off-off' problem has been identified the next issue is what to do about it. ONS will need assistance from the accounting community, both national and international and from HM Treasury in order to reflect these assets and any associated transactions correctly in the National Accounts, for which it is not acceptable to have 'on-on' or 'off-off' assets. ONS cannot assess over 700 projects to determine which entity is the majority owner of the risks and rewards associated with the capital assets.

17. Improved consistency between the accounting guidance available under UK GAAP and from HM Treasury on the treatment of PPP and PFI projects and between national and international guidance is required to reduce or eliminate the likelihood of further 'on-on' and 'off-off' issues in the future.

18. The possibility of a joined up process between all those accounting for a project - where they communicate and work together to ensure a consistent approach - should be considered. In the event of a disagreement an arbiter would be needed.

Summary and recommendation

19. There are several reasons for the potential 'on-on' and 'off-off' problem. They include the lack of consistency in the available guidance and the complicated nature of PFI and PPP projects.

20. The recommended steps toward a solution to the problem detailed in the earlier section titled "What is needed?" are complicated and will be time consuming and challenging to implement. For example, it will not be straightforward to compile a list of all SPVs for over 700 projects.

FRAB members are asked to confirm that the issues stated in this paper accurately reflect the position and the proposals for moving forward cover the main options. The specific differences between the accounting guidance have not been covered by this paper as they are clearly stated in FRAB paper (80) 04, 29 June 2006 and further discussed in a paper by John Pitzer et al, presented at the January 2006 Advisory Expert Group on National Accounts meeting (SNA/M1.06/10 - 'Public-Private Partnerships'). See link::

<http://data.un.org/unsd/nationalaccount/AEG/papers/m4Boot.pdf>

21. Advice and direction from the FRAB members, particularly on the applicability of the proposals for moving forward, is also sought.

22. ONS is keen to work with FRAB and HM Treasury to develop a way of moving forward and to achieve a resolution to this potential problem within a realistic timescale.

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