



'You don't need to put much PFI liability on the balance sheet to break the rule'

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Gordon Brown's reputation for fiscal prudence, which has already taken a battering thanks to the credit crunch, will come under further strain next year when International Financial Reporting Standards are adopted for central government and NHS accounts.

IFRS have already been blamed for escalating the global financial crisis, forcing banks into massive write-downs as the value of assets plummets. The public sector could be next in line to feel the impact. If, as expected, many Private Finance Initiative projects that are currently off the balance sheet are included in government debt as a result of IFRS, the consequences for Labour's credibility could be profound.

The threat stems from the effect the standards will have on the government's self-imposed fiscal rules – in particular the sustainable investment rule, under which Public Sector Net Debt must remain below 40% of national income. Chancellor Alistair Darling's fiscal forecasts in last month's Budget showed PSND rising to 39.8% in 2010/11 – and that is before PFI schemes move on to government balance sheets.

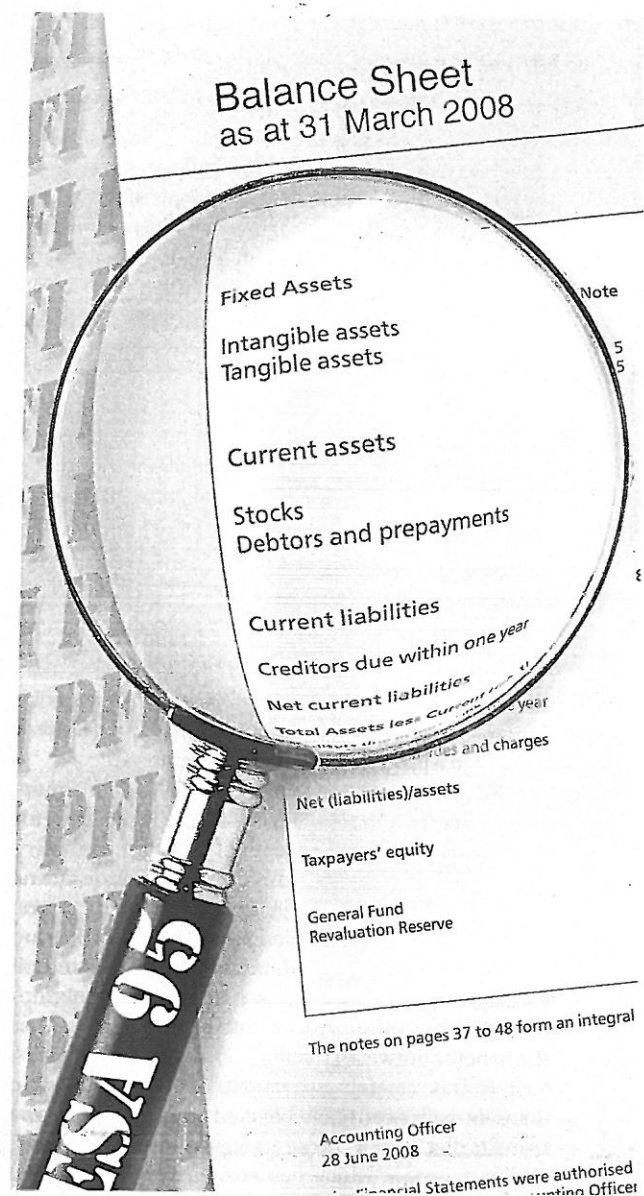
The Treasury is downplaying suggestions that the shift to IFRS is likely to shatter the sustainable investment rule. It says there is no certainty that the adoption of the international standards will lead to any significant reclassification of PFI debt.

At the heart of the debate is the question of whether the Office for National Statistics, which compiles the national accounts, can reconcile accounting standard 12 of the International Financial Reporting Interpretations Committee with statistical standard 95 of the European System of Accounts.

Treatment of PFI assets and liabilities under IFRS will be determined in line with IFRS 12, which specifies that the balance sheet treatment of a contract depends on where control lies. Existing public sector treatment is based on a Treasury interpretation of the current Financial Reporting Standard 5 and on ESA 95, both of which use a determination of where the risk and reward lies. The ESA 95 framework will continue, alongside the IFRS.

Some people within government argue, in private, that the apparent contradiction between IFRS 12 and ESA 95 could mean the ONS decides not to include additional PFI liabilities in the national accounts. Such a decision would be very helpful for the Treasury.

As the Institute for Fiscal Studies think-tank explained to the Commons Treasury select committee's



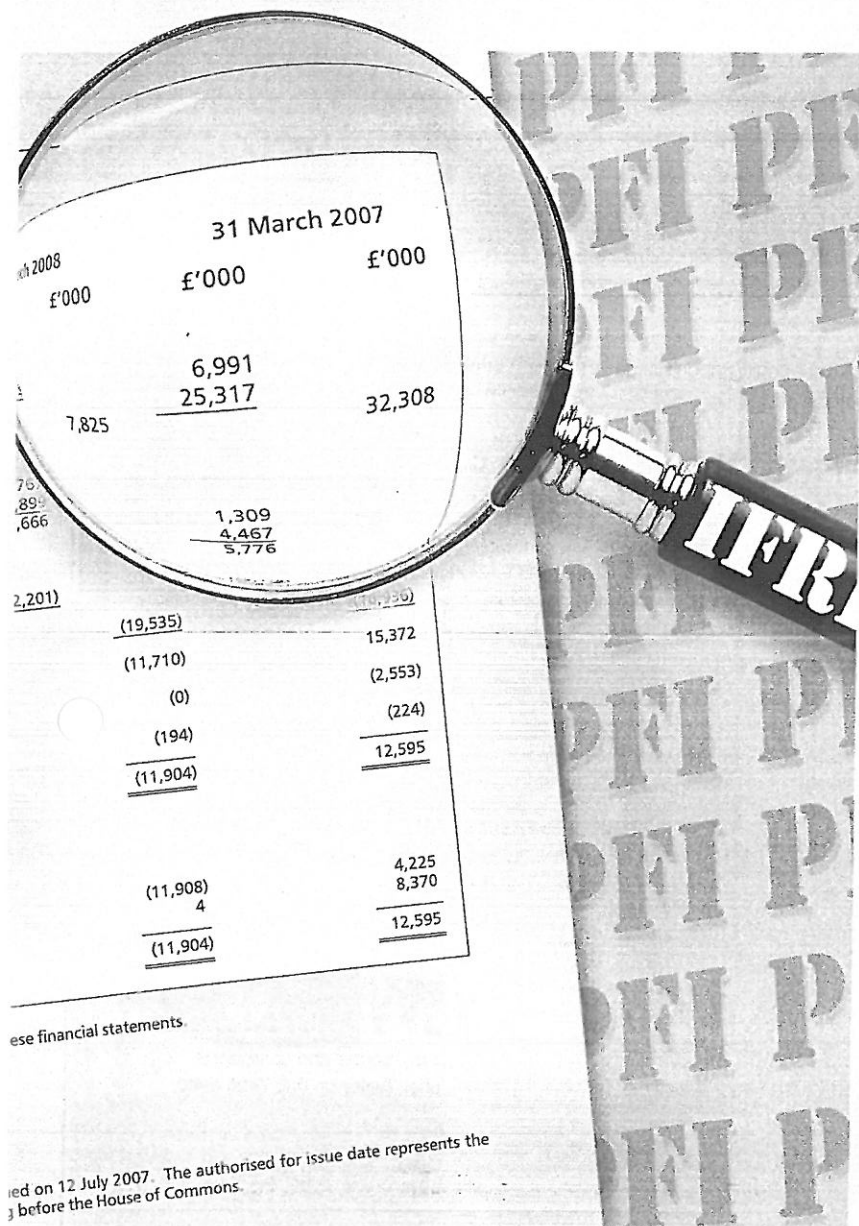
inquiry into this year's Budget, IFRS could add up to £30bn to the government's net debt figure – more than half the total value of PFI schemes. The government has just 0.2% of gross domestic product to play with in 2010/11, so putting even a small proportion of PFI liabilities on the balance sheet would shatter the sustainable investment rule – and with it whatever is left of the government's reputation for fiscal competence.

IFS director Robert Chote says: 'You don't need to put very much on to break the rule. We have no idea how much would be put on – neither did the other experts giving evidence to the Treasury select committee.'

The question has been hanging in the ether for some

The government could find itself caught out by its own fiscal rules if the delayed introduction of International Financial Reporting Standards means that Private Finance Initiative debt goes on the balance sheet. Paul Gosling investigates

Question of balan



time. IFRS were due to be implemented by the government from April, but this has been put off until 2009/10, because neither the Ministry of Defence nor the Department of Health, Whitehall's two biggest PFI users, are sufficiently advanced in trawling contracts to determine which should now go on the balance sheet.

But answers will be needed soon. The ONS is considering what the standards will do to PFI liabilities in statistical and accounting terms. A spokesman says: 'ONS is undertaking research on the consistency of accounting results and approaches across the economy. We will be working with Eurostat this year to analyse a small sample of PFI schemes against the manual on government deficit and debit rules.'

Colin Mowl, ONS executive director for macroeconomics and the labour market, told a one-off Treasury select committee hearing on financial reports and the national accounts that he did not yet know what impact the new standards would have. 'It will depend on precisely how the new IFRS standards are applied in the public sector and we do not yet know whether it will continue to produce similar results to the results you would get from applying national accounts,' he said.

'We are using existing government accounting standards to estimate PSND at the moment but we will be examining the new standards to see whether we need to change our approach going forward.'

Nevertheless, the Treasury committee says the

adoption of IFRS is 'highly likely' to lead to a breach of the sustainable investment rule, and is calling on the Treasury to start making preparations for what will happen if and when it is broken.

But the committee's chair, John McFall, is more cautious than his colleagues about the likely impact of the move. He told *Public Finance* that it was 'an open question' whether it will have a major impact on the public finances. McFall also avoided seriously criticising the Treasury's handling of IFRS, saying it was a complicated issue. 'Just two departments – the Department of Health and the Ministry of Defence – haven't produced reports [on IFRS implementation],' he says. 'The timetable was too tight, anyway, and I accept that the MoD is the most complex department and did need more time.'

Meanwhile, the ONS is trying to square the circle between accounting standards IFRS 12 and ESA 95. The Treasury's own accounting advisers, the Financial Reporting Advisory Board, are taking a cautious view of the outcome. Frab member and Deloitte partner Ken Wild says that while IFRS 12 and ESA 95 'are definitely different rules', interpretations based on them might come down to the same thing. As Wild points out, in many cases – perhaps most – an assessment of risk and reward on the one hand, or control on the other, will produce the same result.

It is the fact that the Treasury's interpretation of FRS 5 is used at present – rather than FRS 5 itself – that has meant more than half of PFI liabilities are off-balance sheet, according to Wild. That is unlikely to happen in future whether IFRS 12 or ESA 95 is used, he says.

Wild believes the ONS will find a way to reconcile the two, and thereby avoid the need to assess all contracts twice. If a reconciliation is impossible, we could see PFI assets and liabilities treated in one way for statistical purposes and another for the national accounts. Wild believes that although the Treasury is pushing for the use of ESA 95 to calculate government debt, the ONS will not be easily swayed. 'I think the ONS sees itself as independent and would not play those games,' he says. 'There is potential confusion if you do the exercise twice with different answers. The ONS is just trying to get to sensible answers.'

Chris Wobschall, assistant director, policy and technical, at CIPFA, agrees that there is a need to ensure consistency in the accounts. 'We share the concerns over the difficulties in applying both a risks and rewards approach, and a control and residual interest approach. We believe the IFRS-based approach is appropriate for government accounts, and hopefully the information will also be suitable for national accounts purposes, avoiding the need for dual accounting.'

But Wild stresses that politics is driving much of the debate behind the scenes. 'The Treasury is worried about changing the way these things are defined and people saying there is more borrowing, when it's just changing the rules – especially at a time of worry about the government's economics,' he suggests.

So is the Treasury trying to have the rules written for the least embarrassing result? 'I have no doubt that is the case,' says Wild. And will they succeed? 'I think ONS may not be convinced by that.'