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The Scottish Government

Finance Circular 4/2010
(as amended by Local Government Finance Circular 6/2011)

By email:
To: Scottish Local Authority Directors of Finance/ Finance Officers

Our ref: B4714809

31 March 2010

Dear Director of Finance / Finance Officer

ACCOUNTING FOR PFI AND SIMILAR ARRANGEMENTS

From 2009-10 accounting for PFI and similar contracts changes. Recognising the financial impact of this change the Scottish Government set out, in a consultation document last year, proposals for the statutory charges to be made for PFI and similar contracts.

One consultation response raised a question on lifecycle replacement costs, which were not covered in the consultation draft guidance. SORP 2009 permits two approaches to the treatment of lifecycle replacement costs, either charging the costs to the unitary payments as they are incurred or setting aside a proportion of the unitary payment each year as a prepayment for the costs that are planned eventually to be incurred. Lifecycle costs may also be a mix of capital and revenue expenditure. This gives rise to some complexity when considering the statutory guidance for this area. Lifecycle replacement costs are now covered in the guidance, which we believe covers all scenarios, but welcome feedback from practitioners should they consider there are any gaps or anomalies.

Another area not covered fully in the original draft guidance are prepayments (or similar assets) held on a local authority balance sheet which represent a payment for the contract asset. On transition, where a local authority has not funded this prepayment (i.e. no charge made to the General Fund, nor any application of capital resources), these costs will need to be funded. The guidance sets out the options available to a local authority.

From 2010-11 the Income and Expenditure Account and the Statement of Total Recognised Gains and Losses are replaced with the Comprehensive Income and Expenditure Statement. The Statement of Movement on the General Fund balance is also replaced with the Movement in Reserves Statement which will include ‘adjustments between accounting basis and funding basis under statute’. The circular as now issued does not fully reflect new statement requirements but authorities should be able to translate the statutory requirements to the new statement requirements. During 2010-11 we will be considering the further changes introduced by Code 2010-11 and will also consider the application of capital receipts for PFI and similar arrangements. We may therefore need to issue a new circular. Should this occur the new terminology will be used.

Circular 4/2010 is issued under section 12(2)(b) of the Local Government in Scotland Act 2003

Any enquiries about this guidance should be addressed to me at:
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Yours faithfully

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GUIDANCE ON PROPER ACCOUNTING PRACTICES – STATUTORY CHARGES FOR PPP/ PFI AND SIMILAR ARRANGEMENTS

Scottish Government

Contents

Part 1 of this document gives informal advice only and is not part of the guidance itself, which is contained in Part 2.

PART 1 - BACKGROUND AND COMMENTARY

Policy Background

1. The 2007 Budget report, published on 21 March 2007, announced that in order to bring benefits in consistency and comparability between financial reports in the global economy and to follow private sector best practice, the annual financial statements of government departments and other public sector bodies will in future be prepared using International Financial Reporting Standards (IFRS) adapted as necessary for the public sector. The original timetable for this was the financial year 2008-09 but this was deferred to 2009-10 in the 2008 Budget report, published on 12 March 2008.

2. Following this announcement the Local Authority SORP Board put together a proposal, with a timetable, for local government to prepare their financial statements using IFRS. The 2009 SORP includes revised accounting arrangements for Private Finance Initiatives, Public Private Partnerships and similar arrangements (PFI). Under accounting arrangements prior to 1 April 2009 a local authority was only required to recognise a PFI related asset on the balance sheet where certain tests were satisfied. The tests included that payments for property can be separated and these can be treated as a finance lease and that the local authority has the benefits and risks of the property. Applying these tests resulted in many PFI assets not being recognised on local authority balance sheets. Under the new arrangements from 2009-10 the criteria for asset recognition has moved from risk and reward to issues about control of service provision and control of the residual value of the asset.

3. The Local Authority Scotland Accounts Advisory Committee (LASAAC) undertook an exercise, in conjunction with a Scottish local authority, to examine the likely impact on local authority reserves (General Fund) arising from the IFRS accounting requirements for PFI arrangements.

4. The local authority that participated in the LASAAC exercise concluded that, based on the Scottish Standard Schools Contract (SSSC), it does have control of

service provision and the residual interest in the assets. As such it is probable that most local authorities in Scotland will recognise PFI assets on their balance sheets from 1 April 2009.

5. From this LASAAC concluded that, without statutory intervention, there is likely to be an impact on local authorities' finances from this change. The 2009 SORP requires local authorities to separate the PFI unitary charge into elements recognising the liability to meet the construction cost of the asset, interest costs arising from the financing arrangements and the service charge for services provided under the arrangement. The 2009 SORP requires, as proper accounting practice, the interest and service charge elements to be charged to the Income and Expenditure account. However, some of the PFI unitary charge may be intended to meet lifecycle maintenance costs, many of which are likely to be capital in nature. In addition, the payment to meet the liability for the construction costs is used to reduce the outstanding liability on the Balance sheet and is not a charge to the Income and Expenditure account. Instead, the charge to the Income and Expenditure account is the depreciation charge for the asset. The depreciation charge is over the useful life of the asset, which may be a different to the period over which the outstanding liability is charged. The result is an expenditure profile that is different to the annual contracted cash terms cost profile. Statutory intervention will determine what costs should be charged to the General Fund each financial year.

6. The intention of the statutory guidance is, as far as possible, to put local authorities in a neutral financial position under IFRS as compared to the previous accounting treatment of PFI arrangements. The guidance applies to the transition arrangements for 2009-10 and also the future treatment of existing and new PFI schemes.

Statutory treatment of PPP / PFI and similar arrangements (PFI)

7. To determine what statutory intervention is required it was necessary to review the status of PFI arrangement as regards debt of the local authority. The Local Government (Scotland) Act 1975 requires each local authority to establish and maintain a loans fund which shall be applicable to all money borrowed by the local authority. Advances from the loans fund are made for any capital expenditure in each financial year that is to be met from borrowing. Advances from the loans fund are required to be repaid over fixed periods, and Scottish Ministers have issued guidance on the fixed periods to be applied. This is known as the statutory charge for the repayment of debt.

8. For the purposes of the Prudential Code, debt refers to the sum of borrowing and other long term liabilities. The outstanding long term liability identified for a PFI arrangement will form part of 'other long term liabilities'.

9. The Scottish Government considers that PFI arrangements are not the borrowing of money under the 1975 Act, rather a long term liability or credit arrangement as identified in the Prudential Code. However, the outstanding long term liability identified on the local authority balance sheet for PFI arrangements is still considered to be debt associated with capital financing. As such any PFI arrangement which a local authority is required to recognise as an outstanding

liability on its balance sheet from 1 April 2009 will come under the Prudential regime and will form part of the capital financing of a local authority.

10. The existing statutory arrangements for the loans fund only apply to the repayment of monies borrowed by the local authority. As PFI arrangements are not considered to be the borrowing of money, the statutory guidance applies the principle that depreciation will not be a charge to the General Fund. The charge to the General Fund will be a sum which recognises the repayment of the principal element of the finance lease component of the PFI liability for the year. This is consistent with the approach taken in the 1975 Act in respect of the statutory borrowing of money.

Lifecycle replacement costs

11. The unitary payment may include an element for lifecycle replacement costs. These costs will largely comprise the replacement of components of an asset as they wear out. The SORP permits a local authority to charge lifecycle costs against the unitary payment as they are incurred or to set amounts aside as prepayments over the contract term. Lifecycle replacement costs that cannot be capitalised will be charged to the Income and Expenditure account in accordance with proper accounting practice. ***The following paragraph deals with lifecycle replacement expenditure which may capitalised in accordance with proper accounting practices***.

12. The approach taken is to require the charge to the General Fund to be made when the capital expenditure is actually incurred. To allow the prepayment to be a charge to the General Fund at the time the prepayment is recognised would create difficulties with the capital accounting framework. Any charge to the General Fund at the point of making the prepayment cannot be identified as a 'revenue contribution to capital' as there is no capital expenditure to be recognised at that point. Later, when the capital expenditure is recognised authorities would need to identify the funding of that capital expenditure. This would not be possible as the funding would have been set aside in previous years. Should local authorities choose to adopt the prepayment method they need to make arrangements to ensure funds are available to finance the capital expenditure when incurred. This may be done by earmarking part of the General Fund balance. Alternatively, authorities may choose to transfer a sum equal to the prepayment from the General Fund to the Renewal and Repair fund. When the capital expenditure is to be financed this can then be transferred back to the General Fund to match the statutory charge required to be made at this time.

Sums set aside as prepayments over the contract term

a) Sums set aside from the unitary payment as a prepayment for lifecycle costs planned within the contract shall not be a charge to the General Fund when set aside. The statutory charge to the General Fund is made when the capital expenditure is actually incurred and the prepayment is used to meet that cost. The approach set out in the following paragraphs shall determine the charge to be made to the General Fund. If it becomes probable during the contract that the programmed lifecycle replacement costs will not take place or the authority believes the prepayment is too large the excess should be charged to the Income and Expenditure Account. Should this occur no statutory adjustment is required. Local authorities would however release a matching amount from the earmarked reserves/ Renewal and repair fund at the same time to support the Income and Expenditure charge

Charging lifecycle costs against the unitary payment as they are incurred

b) Where the capital expenditure is equal to the lifecycle cost identified in the contract the statutory charge to the General Fund is equal to the lifecycle cost. The charge to the General Fund will be made via the Statement of Movement on the General Fund Balance and be recognised as 'Capital expenditure charged to the General Fund balance'

c) Where the capital expenditure is less than the lifecycle costs identified in the contract the statutory charge to the General Fund is equal to the actual capital expenditure recognised as incurred. The charge to the General Fund will be made via the Statement of Movement on the General Fund Balance and be recognised as 'Capital expenditure charged to the General Fund balance'. The difference between the actual capital expenditure incurred and the planned contract value is required to be charged to the Income and Expenditure account in accordance with proper accounting practice. No further statutory adjustment is therefore required.

d) Where the capital expenditure is greater than the lifecycle costs identified in the contract the statutory charge to the General Fund is equal to the lifecycle costs identified in the contract. The charge to the General Fund will be made via the Statement of Movement on the General Fund Balance and be recognised as 'Capital expenditure charged to the General Fund balance'. The excess of expenditure is a gain to be recognised. The asset is effectively 'donated' by the operator, and a grant recognised to fund that acquisition through the creation of 'deferred income'. The deferred capital grant income is then released to the Income and Expenditure account over the life of the asset. This income is not income that may be credited to the General Fund. A statutory adjustment equal to the grant released must be charged to the General Fund via the Statement of Movement on the General Fund Balance and be recognised as 'Grants deferred amortisation matching depreciation and impairment'.

e) Capital expenditure not undertaken that was planned in the contract. If the planned work is still expected to be undertaken later in the contract the relevant part of the unitary payment will be posted to the balance sheet as a prepayment. The prepayment will not be a statutory charge to the General Fund when the prepayment is posted to the balance sheet. The expenditure will only be charged to the General Fund when the capital expenditure is actually incurred. Paragraphs b), c) or d) will then apply.

f) Works undertaken earlier than planned. The capital expenditure will need to be charged to the General Fund as incurred. Paragraphs b), c) or d) will apply.

g) It is possible that lifecycle replacement costs may be substantial enough in any year to exceed the unitary payment after deducting the fair value of services. In such cases the statutory charge to the General Fund is equal to the unitary payment after deducting the fair value of services. The charge to the General Fund will be made via the Statement of Movement on the General Fund Balance and be recognised as ‘Capital expenditure charged to the General Fund balance’. In the subsequent financial year the excess of lifecycle costs will be charged against the unitary payment. This cost will be charged to the General Fund via the Statement of Movement on the General Fund Balance and be recognised as a ‘Statutory repayment of debt’. This recognises that the excess of capital expenditure incurred in the prior year was effectively funded by borrowing in the previous year by increasing the finance lease liability. The charge to the General Fund in the subsequent year repays that debt.

13. The statutory guidance applies to all PFI arrangements where the local authority recognises PFI assets on their balance sheet.

14. LASAAC consulted with Scottish local authorities to seek their views as to whether the period for the repayment of the statutory charge should be the asset life (in line with depreciation) or the contract period. Responses were mixed with support for both approaches. The Scottish Government provides funding for these schemes over the contract period, reflecting the requirement for local authorities to pay the annual unitary charge. If the statutory charge period were to reflect the asset life, and assuming that the asset life is likely to be longer than the contract period, this would provide a mismatch between funding and the financial impact on the local authority’s General Fund. The Scottish Government grant could be re-profiled to match the local authority’s revised cost profile. However, local authorities would still need to make cash payments equal to the annual unitary charge. On balance, and to be pragmatic, the statutory guidance adopts the contract period to be the period over which the outstanding liability is charged to the General Fund.

15. Impairments and the revaluation of assets recognised by local authorities under PFI arrangements shall be accounted for in accordance with proper accounting practices. This means such assets will be accounted for in the same way as other local authority assets. It also means that these costs are not chargeable to the General Fund and are adjusted through the Statement of Movement on the General Fund Balance.

Transition arrangements

16. One objective of the statutory guidance is to ensure that, as far as possible, the transition to IFRS there is no change in usable revenue and capital reserve balances on the restated Balance Sheet.

17. In addition to lifecycle replacement costs, capital contributions have been identified as an area which may give rise to a change. Both are covered in the guidance.

18. The provision of local authority assets, not part of the PFI arrangement, in exchange for reduced or eliminated payments, is considered by the guidance.

19. We are not aware of any other transition impacts that require statutory intervention.

Capital contributions including capital prepayments

20. The statutory guidance will determine the costs to be charged to the General Fund for PFI arrangements. The work undertaken by LASAAC to consider any financial impact on a local authority's General Fund, also considered capital contributions made to PFIs. The conclusion reached was that there will be no impact on the General Fund where historic decisions on the funding or financing of any contribution are not reconsidered or re-addressed, and have been ***fully funded*** from either capital or revenue resources. As such it is not considered desirable that authorities should review and restate, and the statutory guidance does not therefore protect any impact on the General Fund or other Reserves where a local authority chooses to reconsider funded capital contributions made in previous years.

21. As at 31 March 2009/ 1 April 2010 a local authority may have a prepayment (or similar asset) on their balance sheet which represents, or a portion of which represents, a payment for the PFI asset (not the service element) but which has ***not been funded***. That is, the prepayment has just been a movement between 'cash' and 'prepayment' on the balance sheet with no charge to the General Fund or any application of capital resources for that prepayment. The authority will have been amortising the prepayment to the income and expenditure account over the life of the arrangement. On transition the prepayment, as it relates to the PFI asset, will need to be derecognised and applied to write down the finance lease liability. On transition the prepayment will no longer be deferred but be actual expenditure. It is therefore necessary to identify, and apply resources to fund, this capital expenditure. Authorities may fund this capital expenditure either by a charge to the General Fund, Renewal and repair fund, the application of capital receipts or an advance from the loans fund. Where authorities choose to make an advance from the loans fund the statutory repayment period is equal to the original amortisation period of the prepayment. On transition any amortisation of the prepayment to the income and expenditure will have been reversed. The loans fund advance will therefore be for the original value of the capital contribution, with a statutory charge for the repayment of debt to 31 March 2009 being equal to the value of the amortisation reversed. The annual statutory charge for the repayment of this advance should reflect the original amortisation annual values.

Local Authority Assets

22. A local authority may provide the operator with access to existing assets of the authority that are not used in the PFI arrangement but are in exchange for reduced or eliminated PFI payments.

23. Where the arrangement involves the permanent transfer of an asset to the operator, or the asset is provided in the form of a finance lease, the local authority is required to derecognise the asset. The authority is required to recognise the consideration received from the asset / operator. This may be the reduction or elimination of the PFI outstanding liability. The statutory guidance permits the capital

receipt to be applied to the outstanding liability to reflect the reduced liability and hence reduced PFI payments.

24. In such cases no further statutory intervention is required, and the annual charge to the General Fund follows the statutory guidance.

25. Where the arrangement does not involve the permanent transfer of the assets to the operator but is provided as an operating lease no revised balance sheet entries are required to reflect the asset used by the operator. This remains the local authority asset. In such cases the local authority is required to recognise the PFI infrastructure asset (fair value) and the associated long term liability. Over the period of the operating lease the authority will recognise income from the operating lease in the Income and Expenditure Account. At the point the income is recognised, there shall be a corresponding reduction in the long term liability, reflecting the offset arrangements. The statutory charge to the General Fund is unaffected by the operating lease arrangements.

Scottish Government support for PPP, PFI or similar arrangements (PFI)

26. One of the original conditions that authorities had to meet in order to be eligible for Scottish Government grant was that the PFI scheme had to be ‘off balance sheet’. With the introduction of IFRS means that this condition may no longer be met by authorities. Where an authority’s PFI arrangement was originally deemed to be ‘off balance sheet’, and now requires to be shown as an asset of the authority on the balance sheet as a result of the changes in the accounting arrangements, the Scottish Government does not consider the local authority to be in breach of the grant condition and grant will continue to be paid.

27. The statutory guidance for PFI arrangements will not impact the accounting treatment of Scottish Government support for PFI arrangements. This forms part of the General Revenue Grant. As such there is no requirement to apportion the grant and then to match the grant with the new elements of the expenditure and the equivalent service lines.

Debt restructuring

28. PFI arrangements may include clauses that transfer a proportion of any savings arising from a restructuring of the operator’s debt to the local authority. The revised accounting arrangements will require any debt restructuring to be accounted for as a renegotiation of the finance lease. The existing liability shall not be altered but the revised financing terms reflected as a reprofiling of repayments and finance charge.

29. Where the authority receives a share of the benefit from the refinancing as a lump sum this will either be included in deferred income and released to the income and expenditure account over the life of the arrangement if the gain is conditional on the continuation of the arrangement, or as an immediate gain in finance income if unconditional on the continuation of the arrangement. Where the refinancing gain is accounted as deferred income and released to the income and expenditure account over the life of the arrangement no statutory adjustment is required. The statutory

charge for the repayment of the outstanding liability for the PFI arrangement will continue to be charged in accordance with the statutory guidance.

30. However, where the authority recognises an immediate gain a statutory adjustment is required. Statutory guidance permits premiums arising from the refinancing of borrowing to be deferred and charged to the General Fund over time (Finance circular 4 of 2007). The statutory adjustment to be made where the authority recognises an immediate gain from a restructuring of the operator's debt is to credit an equivalent sum to the Financial Instruments Adjustment Account and charge the General Fund. This transfer is to be reported as part of the Statement of Movement on the General Fund Balance (from 2010-11 as Movements in Reserves Statement – adjustments between accounting basis and funding basis under statute). Where a local authority has no outstanding statutory premium balances in the Financial Instruments Adjustment Account this requirement will not apply. If the value of the outstanding statutory premiums held is less than the refinancing gain the transfer is restricted to the value of the outstanding premiums. The refinancing gain is to be released back to the General Fund over the life of the contract.

31. The statutory requirement to transfer the refinancing gain to the Financial Instruments Adjustment Account is prospective only. There is no requirement to amend or restate the General Fund balance to reflect any refinancing gains which have occurred before 1 April 2010.

Use of capital receipts to fund the statutory repayment of debt for PPP, PFI or similar arrangements (PFI)

32. Where, under proper accounting practice applicable prior to 1 April 2009, a local authority concluded that it did not have an asset of the property under a PFI arrangement, the authority recorded the costs related to the payment of the PFI contract (the unitary charge) within the relevant service line within the Income and Expenditure Account.

33. With the change in accounting it is anticipated that most PFI assets will be recognised as local authority assets and the PFI arrangement will be separated into elements recognising the service element of the contract separately from the capital construction costs and the associated financing.

34. Capital receipts are treated separately from revenue income, and may be used in line with the permitted use of the Capital Fund. Paragraph 23 of Schedule 3 of the Local Government (Scotland) Act 1975 permits capital receipts to be used to meet the costs of capital expenditure or to provide money for the repayment of the principal of loans but not the payment of any interest on loans.

35. Applying SORP 2008 a local authority may have recognised an element of the unitary charge as being the cost relating to the residual value (where the authority has a right to receive an asset at the end of the contract) and could feasibly have treated this as capital expenditure. Being capital expenditure this part of the unitary charge could have been funded from capital sources such as borrowing or capital receipts, or through a revenue contribution to capital.

36. The aim of the statutory intervention is to neutralise any financial impact from the proposed change in accounting. However, where an element of the unitary payment relating to the residual value of the asset has previously been funded from capital resources, it is not possible to create a neutral position through statutory guidance. The revised accounting arrangements, based on the asset being on balance sheet, does not recognise any residual element as forming part of the charges to be made to the Income and Expenditure Account. As such there is no capital component to be recognised in this regard. Lifecycle replacement costs are recognised and these costs are addressed in the guidance.

37. However, as discussed above, although PFI arrangements are not considered to be the borrowing of money, rather a long term liability or credit arrangement, the outstanding liability identified on the local authority balance sheet is still considered to be debt associated with capital financing. This raises the question as to whether capital receipts should be able to be applied to reduce the outstanding liability (being the capital construction element of the arrangement and the equivalent of the principal element of borrowing).

38. Where the local authority provides the operator with access to assets not forming part of the PFI arrangement in exchange for a reduced payment for the PFI and on transition to the 2009 SORP is required to de-recognise the asset and recognise consideration for the asset (capital receipt), the statutory guidance permits the capital receipt to be used to reduce the long term liability. This is a transition arrangement. For new PFI arrangements using a capital receipt to finance capital expenditure does not require special consideration.

39. For the borrowing of money, capital receipts may be used to voluntarily write down loans fund advances once made. The use of capital receipts in this way allows previous decisions to borrow to be changed and substituted with capital receipts. This reduces the statutory charge to the General fund for subsequent years. In principle, Scottish Ministers have no difficulty in allowing capital receipts to be applied to PFI arrangements to reduce the statutory charge for future years. Unlike the borrowing of money, the debt is associated directly with the PFI assets. The difficulty therefore is how substituting capital receipts to reduce the long term liability can be achieved when the actual liability will remain. It also complicates the statutory arrangements for the repayment of PFI debt as set out in this guidance.

40. Further work will be undertaken to consider this further. We would wish to ensure that using receipts in this way does not reduce local authorities' ability to fund new capital expenditure. Until the details of how capital receipts may be applied is considered in more detail the statutory guidance will not permit capital receipts to be used to reduce or meet the repayment of the outstanding liability associated with a PFI arrangement.

Finance leases

41. The proposed changes to the accounting for PFI arrangements, and the work associated with assessing any financial impact on local authorities has identified a current anomaly in the current treatment for finance leases.

42. Like PFI schemes finance leases are considered to be credit arrangements and not the borrowing of money. No statutory guidance currently exists to determine the charges to be made to the General Fund. This statutory guidance therefore also sets out the statutory arrangements for finance leases.

Local Government Division ***Scottish Government***

31 March 2010

Victoria Quay, Leith, Edinburgh EH6 6QQ

[PART 2]

GUIDANCE ON PROPER ACCOUNTING PRACTICES – STATUTORY CHARGES FOR PPP AND PFI ARRANGEMENTS

Issued by Scottish Ministers under section 12(2)(b) of the Local Government in Scotland Act 2003

DEFINITIONS

1. ***Local Authority*** means a council constituted under section 2 of the Local Government etc. Act 1994 (c.39), a joint police board, a joint fire board, regional transport partnerships and other bodies as set out in section 106 of the local Government (Scotland) Act 1973.

2. ***General Fund*** means the fund as detailed in section 93(1) of the Local Government (Scotland) Act 1973.

3. ***Proper accounting practices*** are those practices as set out by section 12 of the Local Government in Scotland Act 2003

4. A Public Private Partnership (***PPP***), a Private Finance Initiative ***(PFI)*** or similar contract typically involves a private sector entity (the operator) constructing or upgrading infrastructure used in the provision of a public service, and operating and maintaining that infrastructure for a specified period of time. These arrangements involve the operator undertaking an obligation to provide infrastructure (and related services) that are used to provide services to the public. The operator is paid for its services over the period of the arrangement.

5. ***Infrastructure*** refers to the property plant or equipment provided by the operator.

6. A ***relevant PFI,*** includes a PPP, PFI or similar contract and is one which requires the local authority to recognise the infrastructure associated with the PPP, PFI or similar contract as assets of the local authority in accordance with proper accounting practice.

7. A ***financial year*** is one that commences on 1 April and ends on 31 March.

8. The annual ***unitary payment*** is the payment due to the operator for any financial year.

9. A ***capital receipt*** is the proceeds from the sale of fixed assets of the local authority.

10. A ***long term liability*** associated with a relevant PFI is the related liability, or debt, recognised by the local authority when the local authority recognises the PFI

asset as property plant and equipment of the local authority. The repayment of this liability by the General Fund is set out in this guidance.

APPLICATION

11. This statutory guidance applies to all relevant PFIs.

12. This guidance applies from the financial year commencing 1 April 2009 and all subsequent financial years. It applies only in Scotland.

PRIOR YEAR ADJUSTMENTS

13. Where, in accordance with proper accounting practice, the local authority is required to restate the opening balance sheet at 1 April 2009, or restate comparative figures for 2008-09 for relevant PFIs, the guidance set out below should also be applied to those restatements. This will ensure, as far as possible, that the total for the General Fund, Capital Fund, Insurance Fund and Renewal and Repair Fund balances remain equal to the total of the pre- restated audited balances as at 31 March 2009.

14. Differences may occur where the local authority has chosen to adopt the option to set aside a proportion of the unitary payment each year as a prepayment for the lifecycle replacement costs that are planned in the contract. Local authorities must make appropriate arrangements to be able to finance the actual capital expenditure when it occurs.

15. A statutory adjustment is required where a local authority has a prepayment (or similar transaction) on their balance sheet which represents, or a portion of which represents, a payment for the contract asset and for which the local authority has not funded from revenue or capital resources (i.e. the prepayment or similar has just been a balance sheet movement between cash and prepayment) On transition the authority must fund the prepayment. This may be either, or a combination of, (i) a charge to the General Fund, (ii) a contribution from Renewals and Repair fund, (iii) the application of capital receipts / Capital Fund or (iv) an advance from the Loans Fund.

16. On transition local authorities will be required to reverse any amortisation of the prepayment that has been charged to the income and expenditure account. Where an authority has not funded the prepayment a sum equal to the amortisation reversal for the prepayment shall be charged to the General Fund.

17. Where a local authority chooses to fund the prepayment as an advance from the loans fund an annual statutory charge for the repayment of this advance shall be charged to the General Fund. This may either reflect the original amortisation annual values or be on a straight line basis. The statutory repayment period is equal to the original amortisation period of the prepayment.

STATUTORY CHARGES FOR A RELEVANT PFI

18. Depreciation costs are to be charged to the Income and Expenditure account of a local authority in accordance with proper accounting practices. Depreciation costs are to be excluded when determining the movement on the General Fund balance for the financial year.

19. Impairment costs are to be charged to the Income and Expenditure account of a local authority in accordance with proper accounting practices. Impairment costs are to be excluded when determining the movement on the General Fund balance for the financial year.

20. Unitary payments to the operator for a relevant PFI are to be charged to the Income and Expenditure Account in accordance with proper accounting practice.

21. In any financial year two statutory charges may need to be made – one for the repayment of the debt (the long term liability) and one to fund any capital expenditure associated with the relevant PFI asset. The statutory charge to fund capital expenditure should be treated as a capital expenditure charged to the General Fund.

Statutory charge for the repayment of debt

22. When determining the movement on the General Fund balance for the financial year a '**Statutory charge for the repayment of debt'** shall be made for a relevant PFI. This statutory charge to the General Fund in any financial year shall be a sum equal to the unitary payment in respect of the financial year after deducting:

a) those amounts which have been charged to the Income and Expenditure Account in accordance with proper accounting practices, adjusted as necessary for paragraph 23 below; **and**
b) actual lifecycle replacement costs capitalised in year. The value deducted for lifecycle replacement costs shall not exceed the planned lifecycle replacement costs as set out in the contract. The value to be deducted for works undertaken earlier than planned is equal to the planned value as set out in the contract ignoring the planning year. Where the capital expenditure exceeds the balance of the unitary payment after deducting those costs identified in a) above the statutory payment for the repayment of debt shall be zero; **or**
c) prepayments posted to the balance sheet for future lifecycle replacement costs.

23. Where a local authority has adopted the prepayment option for lifecycle replacement costs and the work is either not undertaken or the costs were less than planned an adjustment is required. A sum equal to the prepayment written off to the Income and Expenditure Account is to be disregarded when determining the value of 22 a) above. Where the prepayment relates to lifecycle replacement costs which may not be capitalised any charge to the Income and Expenditure for lifecycle replacement costs shall be disregarded when determining the value of 22 a) above.

24. Where the capital expenditure exceeds the unitary payment after deducting those costs as identified in 22 a) above the excess of actual lifecycle costs will be charged to the unitary payment in the subsequent financial year. For the purposes of

paragraph 22 b) above those excess costs when met from the unitary charge are not to be deducted as actual lifecycle replacement costs capitalised in year.

25. The statutory charges made for the repayment of the principal element of the debt represents the repayment of the long term liability associated with a relevant PFI. The total charge to the General Fund for any relevant PFI should be equal to the long term liability recognised for the PFI infrastructure. Adequate records must be kept to demonstrate that the General Fund has been correctly charged.

26. Prepayments posted to the balance sheet for future lifecycle replacement costs may not be a charge to the General Fund when recognised. Authorities may transfer sums from the General Fund to the Renewals and Repair fund should they wish to identify and set aside funds to finance the capital expenditure when it occurs.

Statutory charge for lifecycle replacements - capital expenditure

27. When determining the movement on the General Fund balance for the financial year a statutory charge '**Capital expenditure charged to the General Fund**' shall be made for a relevant PFI. This statutory charge to the General Fund in any financial year shall be a sum equal to

a) the actual lifecycle replacement expenditure capitalised in year in accordance with proper accounting practice where this is less than the planned replacement cost; **or**
b) the actual lifecycle replacement cost where this is equal to the planned replacement cost; **or**
c) the planned replacement cost where the actual expenditure exceeds the planned replacement cost, **or**
d) where the capital expenditure is equal to, or less than, the planned expenditure but exceeds the unitary payment (after deducting those amounts charged to the Comprehensive Income and Expenditure Statement) together with any balance of lifecycle prepayments, the statutory charge for the year is equal to the lifecycle prepayment plus the balance remaining of the unitary payment after deducting those amounts charged to the Comprehensive Income and Expenditure Statement[1].

28. The planned replacement cost in paragraph 27 refers to the lifecycle replacement expenditure recognised in the relevant PFI. In determining the statutory charge to be made the timing of the planned cost identified in the relevant PFI shall be disregarded. For example if the replacement is planned to occur in 2012-13 but is incurred in 2011-12 the cost shall still be treated as planned for the purposes of determining the statutory charge.

29. Adequate records must be kept to demonstrate that the General Fund has been correctly charged with the capitalised lifecycle replacement costs. Returns to the Scottish Government for capital expenditure shall include capital expenditure recognised as incurred on relevant PFI assets. The financing of that expenditure will be the revenue contribution to capital.

[1] Paragraph 27 d) was amended by Local Government Finance Circular 6/2011 from 1 April 2010

DEBT RESTRUCTURING – MOVEMENT ON THE GENERAL FUND BALANCE

30. PFI and similar arrangements may include clauses that transfer a proportion of the savings arising from the restructuring of the operator's debt to the local authority. Where a local authority receives a share of the benefit from the refinancing as a lump sum and recognises this as an immediate gain in finance income in the income and expenditure account a statutory adjustment must be made. The Financial Instruments Adjustment Account shall be credited, and the General Fund debited, with an equivalent amount as the refinancing gain recognised. This transfer is to be reported as part of the Statement of Movement on the General Fund Balance (from 2010-11 as Movements in Reserves Statement – adjustments between accounting basis and funding basis under statute).

31. Where the value of statutory premiums held in the Financial Instruments Adjustment Account is less than the refinancing gain recognised in the income and expenditure the credit to the Financial Instruments Adjustment Account is reduced. The credit, and associated debit, shall be equal to the outstanding value for statutory premiums forming part of the Financial Instruments Adjustment Account.

32. Where the value of statutory premiums held is zero paragraph 30 does not apply

33. The requirement in paragraph 30 only applies to refinancing gains arising in the financial year commencing 1 April 2010, and future financial years.

34. The refinancing gain shall be released back to the General Fund over the contract period. This transfer is to be reported as part of the Statement of Movement on the General Fund Balance (from 2010-11 as Movements in Reserves Statement – adjustments between accounting basis and funding basis under statute).

DONATED ASSETS

35. Where the capital expenditure is greater than the lifecycle costs identified in the contract the statutory charge to the General Fund is equal to the contract cost. The excess of expenditure is a gain to be recognised. The asset is effectively 'donated' by the operator and, where all conditions are met, income is recognised in the Comprehensive Income and Expenditure Statement. This income is not income that may be credited to the General Fund and therefore when any such donated asset is recognised in the Comprehensive Income and Expenditure Statement a statutory adjustment equal to the income recognised must be charged to the General Fund via the Movement in Reserves Statement[2].

STATUTORY CHARGE FOR THE REPAYMENT OF FINANCE LEASES

36. Finance leases are a method of financing capital expenditure. They do not represent the borrowing or money but rather a credit arrangement. As such it represents debt associated with capital financing. Where assets are acquired through a finance lease, and where the expenditure may be properly capitalised in

[2] Paragraph 35 was amended by Local Government Finance Circular 6/2011 from 1 April 2010

accordance with proper accounting practices, the following statutory guidance applies:

37. Depreciation costs are to be charged to the Income and Expenditure account of a local authority in accordance with proper accounting practices. Depreciation costs are to be excluded when determining the movement on the General Fund balance for the financial year.

38. Impairment costs are to be charged to the Income and Expenditure account of a local authority in accordance with proper accounting practices. Impairment costs are to be excluded when determining the movement on the General Fund balance for the financial year.

39. When determining the movement on the General Fund balance for the financial year a '**Statutory charge for the repayment of debt'** shall be made for a finance lease. This statutory charge is equal to the annual lease charge after deducting those amounts which have been charged to the Income and Expenditure account for interest in accordance with proper accounting practices.

APPLICATION OF CAPITAL RECEIPTS

Transition arrangements

40. Where, in accordance with proper accounting practice, the local authority is required to derecognise an asset made available to the operator where this asset is not the subject of the relevant PFI, and to recognise the consideration received (capital receipt) for the asset de-recognised, the capital receipt may be applied to reduce the outstanding liability recognised for the relevant PFI.

41. Capital receipts may be applied in accordance with paragraph 15 above.

Use of capital receipts in relation to relevant PFI – after transition

42. Capital receipts may not be used to reduce the long term liability, repay the long term liability, or fund the statutory charge associated with a PFI arrangement.

43. Capital receipts may not be used to reduce the long term liability, repay the long term liability, or fund the statutory charge associated with a finance lease.

Scottish Government ***31 March 2010***

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