



**Our reference** PJ/TP/JM/CP/20081007

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Dear Dave

## **Warwickshire County Council - Request for audit view for the initial view of the accounting opinion on the Project Transform Waste PFI project**

You have requested my comments on the reasonableness of the initial accounting view of the proposed accounting treatment for the jointly procured Project Transform Waste PFI Project. I set out below my views and the context within which they are provided to you.

### **Responsibilities of the audited bodies and the auditor**

Warwickshire County Council (the Council) is accountable to the public for the stewardship of funds under its control. It is for the Council alone to take decisions about the most appropriate accounting treatment for any transactions it is considering entering into, after taking into account whatever advice it deems necessary.

The *Code of Audit Practice* (the Code), published by the Audit Commission, determines the responsibilities of the auditor and the scope of the external audit. It is the external auditor's role to form an independent view on how each Council has discharged its stewardship of public funds. It is not part of the auditor's role to provide accounting advice or to act as an accounting advisor. The public sector audit regime requires that auditors should not, nor appear to, compromise their independence or fetter their discretion at a future audit.

I would also draw your attention to the *Statement of Responsibilities of Auditors and Audited Bodies* published by the Audit Commission, which sets out clearly the respective responsibilities of the external auditor and the audited body. In particular, paragraphs 37 and 38 specify the role and responsibilities of the auditor in relation to requests for auditors' views.

## Status of audit view

The purpose of this letter is to respond to the request for a view on the proposed accounting treatment for the jointly procured Project Transform Waste Private Finance Initiative (PFI) scheme from the perspective of the external auditor. The views are provided in my capacity as auditor, according to the principles set out in the Audit Commission's *Statement of Responsibilities of Auditors and Audited Bodies* on the provision of audit views and should not be regarded as advice. The letter is provided purely to inform you of my views as auditor and for no other purpose. In particular, no responsibility is accepted towards any other organisation or individual that may seek to place reliance on its contents.

My views are expressed in the context of the current underlying guidance which, for this purpose, I have taken as:

- Application Note F to *FRS 5 Reporting the Substance of Transactions*. In the local government context, the *Statement of Recommended Practice (CIPFA's Code of Practice on Local Authority Accounting in Great Britain)* provides the framework for reporting PFI transactions through the adoption of FRS 5.
- *CIPFA's Guidance Notes for Practitioners* suggest that the contents of *Treasury Task Force Technical Note 1 (Revised)* on 'How to Account for PFI Transactions' (TTN1) will also be of interest when considering the accounting treatment of a PFI scheme, and regard has also been shown to this in forming my views.
- The Audit Commission's *Standing Guidance for Auditors*, which defines the terms and conditions of auditors' appointments, requires me to have regard to the TTN1 in forming my view about the accounting treatment of a PFI scheme.

## Changing circumstances

Auditors may not fetter the exercise of their discretion in the event of additional information coming to their attention. Nothing in this letter should be taken to fetter the exercise of my discretion.

My views at this stage are based upon the information provided to me as at 3 October 2008 in the documents listed in the Annex to this letter. If these facts change during negotiations or as the scheme progresses, or if further relevant information becomes available or accounting standards or guidance change then my views may have to be reconsidered.

In particular, I understand that local authority financial statements will have to be prepared in accordance with International Financial Reporting Standards (IFRS) from the financial year 2010/11. The accounting assessment does not discuss the potential accounting for the transaction under IFRS. At the point of adoption of IFRS, my views may have to be reconsidered.

The final judgement on the proposed accounting treatment will be given when the project has to be accounted for in the Council's financial statements. It will be for the Council's auditors at that time to give the final judgement on the scheme's accounting treatment.



## Background

Coventry City Council (CCC), Solihull Metropolitan Borough Council (SMBC) and Warwickshire County Council (WCC) (the 'Councils') have entered into a Memorandum of Understanding which creates a commitment to work together for mutual benefit in the area of waste management and waste disposal.

Following a feasibility review for joint residual waste procurement, the Councils submitted a joint Expression of Interest to DEFRA under the title of 'Project Transform'. This application for PFI credits was primarily for the procurement of a waste service for the reception, handling, treatment and disposal of residual municipal waste generated by the three authorities (all of that from CCC and SMBC, and a proportion of that from WCC).

The proposed contract would be service based and therefore there will be an opportunity for bidders to provide their own technology solutions. However, a reference project has been developed by the Councils which is based on the construction of a new Energy From Waste (EFW) plant with a capacity of 305,000 tonnes per annum. A site has also been identified for the reference project: this would be developed adjacent to an existing EFW plant which is jointly owned and operated by CCC and SMBC via the Coventry and Solihull Waste Disposal Company.

Procurement is scheduled to begin early in 2009 and the target date for financial close is March 2011. The reference project assumes that a planning application for the EFW site would be submitted in 2011, and if successful, the EFW plant would become fully operational in April 2015: the contract is then expected to run for 25 years from this date.

## Comments on the reasonableness of the initial view of the proposed accounting treatment

In your capacity as the Strategic Director, Resources, you have confirmed to me that your final judgement on the proposed accounting treatment, considered under FRS 5, is that the transactions should be accounted for as off the Council's balance sheet i.e. that no newly created fixed assets arising from the transaction will be recognised in the Council's financial statements.

CCC appointed Grant Thornton LLP (GT) as the financial advisors for Project Transform. As part of their remit, they have provided the Councils with advice on whether this transaction should be accounted for as on or off the Councils' balance sheets. GT has produced ONE accounting opinion for the project because the risks associated with the project are being shared proportional to waste tonnage input. I am satisfied that this approach is acceptable at this stage, and support the view that separate accounting opinions will be required at the Final Business Case stage should the risk profiles of the participating authorities be significantly different.

GT's accounting treatment assessment, dated September 2008, has been prepared by applying the provisions of TTN1. This is limited to an initial assessment of the risks and qualitative indicators because the project is at a point where the tendering process has not yet begun. Therefore no detailed negotiations have taken place and the terms of the Project Agreement and the Payment Mechanism have not yet been drafted.



The overall conclusion from GT's initial accounting assessment and the qualitative indicators is that *'based on the assumptions made the contractor would bear the majority of risk and the assets created would be off the balance sheet of the councils. However, there is not sufficient evidence to enable conclusion to be drawn based upon a qualitative analysis alone, and at the Final Business Case stage a full quantitative assessment will be undertaken based on the Selected Bidders proposed solution to support the conclusions of the qualitative assessment.'*

In terms of IFRS, GT noted the government's intention to move towards applying International Financial Reporting Standards in the public sector. However, no guidance has yet been published as to the implications for accounting for UK PFI transactions, and *'as such the accounting opinion and any accounting guidance that is given by Grant Thornton remains caveated subject to these developments.'* At the point where public sector financial statements are prepared under IFRS (from 2010/11), my views may also have to be reconsidered.

GT's accounting Advice is issued in 'Draft' format because the financial information included within it is still being finalised.

## **Conclusion**

Based on the evidence presented to me, I am not currently minded to challenge the Council's conclusion that based on the assumptions made, the contractor would bear the majority of risk and the assets created could be off the council's balance sheet. However, at this stage there is insufficient evidence to enable a conclusion to be drawn based on a qualitative analysis alone.

I cannot fetter my discretion in the event of a future challenge, and my current view is provided in the context that:

- The Council's advisors are still able to conclude that the property assets should not be included on Councils' balance sheets;
- The scheme proceeds as outlined in the information made available to me;
- The legislation, accounting standards, direction and guidance applicable to the Council's accounts remain unchanged; and
- No other matters come to my attention which would lead me to believe that the proposed accounting treatment is inappropriate.



Finally, I must again emphasise that it is for the Council, with the benefit of advice from its legal and financial advisors, to make decisions regarding accounting treatment.

Yours sincerely

Phil Jones

Phil Jones  
*Head of Operations*

**cc** Dave Rigg, District Auditor, Audit Commission;  
Mike Allen, Senior Technical Manager, Audit Commission;  
Tony Parks, Audit Manager, Audit Commission;  
Julie Murray, Technical Manager, Audit Commission



## **Annex – Documents presented to the District Auditor**

- *Coventry City Council, Solihull Metropolitan Borough Council, and Warwickshire County Council – Initial Accounting Opinion View for the Joint Project Transform Waste PFI Project.* Grant Thornton LLP (September 2008)
- *Project Transform – An expression of Interest for PFI Credits on behalf of Coventry City Council, Solihull Metropolitan Borough Council, and Warwickshire County Council* (31 March 2008)
- *Feasibility Review for Joint Residual Waste Procurement.* PricewaterhouseCoopers LLP (November 2007)
- *Project Transform Affordability Model 13.* Grant Thornton LLP (September 2008)
- *Project Transform Shadow Price Model V9.* Grant Thornton LLP
- *Draft Outline Business Case v9* (September 2008)

