

DECC

Green Deal Finance

Public Sector considerations
for the Green Deal

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Contents

1.	Introduction	1
1.1	Purpose of this report	1
1.2	Limitations of our report	1
1.3	Key Assumptions	2
1.4	Use of our report	3
1.5	Information used in the production of this report	3
1.6	Structure of this report	3
1.7	Glossary of terms	3
2.	Executive Summary	4
2.1	Background to the Green Deal	4
2.2	Accounting for the Green Deal in PS/QPS customers	5
2.3	Overview of some key relevant PS/QPS reporting and finance considerations	6
3.	Accounting for the Green Deal in PS/QPS customers	7
3.1	Relevant accounting frameworks and standards	7
3.2	Relevant accounting treatments	8
3.3	Accounting for the Green Deal in PS/QPS owner-occupiers	11
3.4	Accounting for the Green Deal in PS/QPS tenants	14
4.	Overview of some key relevant PS/QPS reporting and finance considerations	16
4.1	Central Government Departments	16
4.2	Local Government	20
4.3	NHS Bodies	23
4.4	Higher Education Institutions	24
4.5	Social Housing	24
4.6	Charities	25
	Appendix 1 - Glossary of Terms	26
	Appendix 2 – DECC's representation of the financing structure	30

1. Introduction

Deloitte has been appointed by the Department for Energy and Climate Change (“DECC”) to assist it in considering at a high level the potential accounting consequences of the Green Deal for public sector and quasi-public sector (“PS/QPS”) participants. The work we have carried out is in accordance with our letter of engagement dated 18 March 2011.

1.1 Purpose of this report

Because the Green Deal is intended to be a market-led private sector initiative, the exact terms of the Green Deal and the Green Deal finance mechanism are as yet unconfirmed and a range of possible contractual and financing arrangements is being researched by DECC. In addition, the legal framework for the Green Deal is not yet confirmed; draft primary legislation (The Energy Bill) is currently under discussion in parliament and we understand that DECC intends to consult on secondary legislation in Autumn 2011. The impact of these possible legislative, contractual and financing arrangements will vary with respect to the resulting financing, credit and accounting implications. This report outlines the potential accounting treatments of the Green Deal for PS/QPS participants and the potential accounting consequences for their balance sheet and income statements.

Examples of public PS/QPS bodies included in this Report are:

Public sector

- Central Government Departments and their Agencies;
- NHS entities – both Foundation Trusts (“FT”), non FTs and Primary Care Trusts; and
- Local Government Authorities.

Quasi-public sector

- Higher Education Institutions;
- Social Housing Entities; and
- Charities.

These are defined further in the Glossary in Appendix 2.

Some of these entities report under adapted versions of UK GAAP and IFRS, but more importantly some are subject to financing and reporting restrictions which are potentially triggered by their involvement in the Green Deal. Therefore this report also seeks to set out some of the potential PS/QPS considerations in light of those financing and reporting constraints; where we have set out some of the potential accounting consequences for PS/QPS entities, it may be necessary to overlay the wider public sector guidance. The report is not intended to cover an exhaustive list of considerations but highlights some of the key issues likely to be relevant.

This report does not constitute an accounting opinion. It merely looks at the theoretical accounting treatments inherent in the deal and in light of current UK GAAP and IFRS accounting standards for potential Green Deal PS/QPS participants and based on various assumptions as agreed with DECC. As the final contractual and finance structures for the Green Deal emerge, the expected accounting treatment for some of the parties may change.

1.2 Limitations of our report

This report assumes that the contractual and finance structure will be as set out in Section 2.1 “Background to the Green Deal” below, as agreed by you in your email of 21 April 2011. Any changes to the structure may result in a different analysis of the accounting consequences of the structure for some or all participants.

The scope of our work in preparing this report was limited solely to providing advice on the key potential accounting treatments of the Green Deal for UK-based PS/QPS participants. You are responsible for

determining whether the scope of our work specified is sufficient for your purposes and we make no representation regarding the sufficiency of these procedures for your purposes. If we were to perform additional procedures, other matters might come to our attention that would be reported to you.

This report should not be taken to supplant any other enquiries and procedures that may be necessary to satisfy your requirements and, in particular, we have not considered the commercial and economic merits of the Green Deal.

This report has been written in general terms and therefore cannot be relied on to cover specific situations; application of the principles set out will depend upon the particular circumstances involved and we recommend that you obtain professional advice before acting or refraining from acting on any of the contents of this report.

The procedures we performed did not constitute a review or an audit of any kind. We did not subject the information contained in our report or given to us by DECC to checking or verification procedures except to the extent expressly stated above. This is normal practice when carrying out such limited scope procedures, but contrasts significantly with, for example, an audit. The procedures we performed were not designed to and are not likely to reveal fraud.

1.2.1 Accounting Considerations

The following specific limitations of scope apply to section.

- Our advice is based on UK GAAP, FRSME and IFRS as at the date of the report. You should be aware that the requirements of UK GAAP, FRSME and IFRS may change over time and that it is your responsibility to take account of the impact of any such changes. We will not be under any obligation to update or otherwise alter our advice subsequent to the date of our final opinion.
- We have not considered the accounting impact on any theoretical Special Purpose Vehicles (“SPVs”) which may be set up for the implementation of the Green Deal, as the contractual and finance structure are as yet undetermined.

1.3 Key Assumptions

The following general assumptions apply throughout:

- We have assumed the Green Deal will operate as described in section 2.1 below “Background to the Green Deal”.
- We have assumed Green Deal Agents will receive remuneration for their role, which may potentially include acting on behalf of the Green Deal Provider for:
 - Assessment of the property for the purposes of the Green Deal, although this may be carried out by the Green Deal Agents themselves, by a subcontractor to the Green Deal Agent or Green Deal Provider or by another independent accredited Green Deal assessor;
 - Installation of the recommended measures for that property, which may be carried out by the Green Deal Agents themselves, by a subcontractor to the Green Deal Agent or Green Deal Provider or by another independent accredited Green Deal installer; and
 - Planned and reactive maintenance services on the installations, which may be carried out by the Green Deal Agents themselves, by a subcontractor to the Green Deal Agent or Green Deal Provider or by another independent accredited Green Deal installer.
- Unless stated otherwise, we have assumed that:
 - All energy customers pay their energy charges and Green Deal charges via regular direct debit or BACS, irrespective of such charges being based on actual energy consumption or estimated consumption. We have not considered customers using prepaid energy meters.
 - All tenants who are Green Deal customers are directly responsible for energy payments to their Energy Suppliers, i.e. we have not considered, for example, tenants who pay their energy charges via service charges from their landlord.

1.4 Use of our report

This report has been prepared solely for the exclusive use of DECC and solely for the purpose of assisting you in your consideration of the potentially appropriate accounting treatments for the Green Deal as you develop further your proposed framework, operational, and structural options. This report is not to be used for any other purpose, recited or referred to in any document, copied or made available (in whole or in part) to any other person without our prior written express consent. We have already consented to your publishing this report for the following purposes:

- publication on your website
- For inclusion in legislative guidance

We accept no duty, responsibility or liability to any party, in connection with the report or this engagement.

1.5 Information used in the production of this report

Our work has drawn on the following sources of information.

- The following attachments from an email from DECC of 21 February 2011:
 - “Figure C1.pptx” (included as Appendix 2 to this report);
 - “GD Participantsv4.pptx”;
 - “Green Deal Finance consultation 25 1 11 FINAL.PDF”;
 - “GD Finance community FINAL.ppt”;
 - “GDLF Monzani Citi investor seminar 24 January 2010.ppt”
 - “GDLF Monzani Good Homes Alliance 1 December 2010.pptx”
- Minutes of the opening meeting with DECC on 22 February 2011. In this meeting DECC provided to us the background and structure of the Green Deal and list of expected stakeholders; and DECC’s investment projections for the Green Deal provided to us via email on 1 March 2011.

1.6 Structure of this report

Our report is set out below as follows:

1. Introduction
2. Executive Summary
3. Accounting for the Green Deal in PS/QPS customers
4. Overview of some key relevant PS/QPS reporting and finance considerations

1.7 Glossary of terms

Where names or phrases are capitalised, they are either titles of sections within this report (in which case this will be clearly indicated in the context) or they are specific terms which have been defined in the Appendix 1 “Glossary of Terms”. The Green Deal specific terms have been agreed by you in your email of 21 April 2011.

2. Executive Summary

2.1 Background to the Green Deal

We understand from DECC that background to the Green Deal is as follows:

The Energy Bill includes provision for a new “Green Deal” which will allow private sector market participants to offer energy customers the opportunity to make energy efficiency improvements to their homes and premises at no upfront costs, potentially revolutionising the sector. Through the Energy Bill, DECC is developing a legal and regulatory framework to support the Green Deal. The Green Deal will be a market mechanism, funded by private capital and implemented by private sector market participants. The financing mechanism is key to the Green Deal; the upfront capital is paid by the Green Deal Provider who will recoup payments through a charge on the properties’ energy bills. The Golden Rule, the principle that the expected financial savings must be equal to or greater than the costs attached to the energy bill at the time of the assessment, sits at the heart of the Green Deal and is a key consumer protection mechanism. The Green Deal will be available to both owner occupiers and tenants in the domestic and commercial sector.

We understand that Green Deal customers will be able to see the Green Deal charge alongside the reductions in energy use which generate savings on their bill. The charge is attached to the energy bill at the property which means the energy customer is only liable to pay the instalments related to the period for which they are the energy bill payer. The charge remains with the energy bill for the property when they move out and the obligation to pay for future periods passes to the next bill payer at that property. In this way, the Green Deal differs from lending – it is not a conventional loan since the bill-payer is not liable for the full cost of the assessment, installation and financing, only the charges due in respect of the period for which they are the energy customer. The possible roles of the Green Deal Provider include:

- (i) Assessment of the property for the purposes of the Green Deal, although this may be carried out by the Green Deal Providers themselves, by a subcontractor to the Green Deal Provider or by another independent accredited Green Deal assessor;
- (ii) Installation of the recommended measures for that property, which may be carried out by the Green Deal Providers themselves, by a subcontractor to the Green Deal Provider or by another independent accredited Green Deal installer;
- (iii) Planned and reactive maintenance services on the installations, which may be carried out by the Green Deal Providers themselves, by a subcontractor to the Green Deal Provider or by another independent accredited Green Deal installer; and
- (iv) Financing of the assessment and installation of the recommended measures.

The customer’s main contractual relationship is expected to be with the Green Deal Provider.

2.2 Accounting for the Green Deal in PS/QPS customers

We have assessed the proposed structure of the Green Deal in light of The UK Generally Accepted Accounting Practice (UK GAAP) and International Financial Reporting Standards (IFRS), with detailed analysis contained in the main body of the report. A summary of our findings is set out here in Figure 2-1 below:

Figure 2-1: summary of accounting treatments

PS/QPS type	Energy consumption pre-Green Deal	Energy consumption post-Green Deal	Green Deal installation - impact on assets	Green Deal installation - impact on liabilities	Green Deal installation - impact on service concession accounting	Accounting for energy meters	Section Reference
Owner/occupier	Executory contract. No balance sheet impact expect in respect of unpaid energy bills	Executory contract. No balance sheet impact expect in respect of unpaid energy bills	Recognise fixed assets reflecting fair value of installation. Depreciated over Useful Economic Life	Liability reflecting repayments due. Specific disclosure potentially required reflecting special nature of the liability	No impact. The absence of specified services in the current contract structure, subject to performance deductions, precludes the use of service concession classification	No balance sheet impact. Meters remain property of Energy Suppliers	3.3
Tenant	Executory contract. No balance sheet impact expect in respect of unpaid energy bills	Executory contract. No balance sheet impact expect in respect of unpaid energy bills	Recognise fixed assets (leasehold improvements) reflecting fair value of installation. Depreciation may be charged over life of the lease	Liability reflecting repayments due. Specific disclosure potentially required reflecting special nature of the liability	No impact. The absence of specified services in the current contract structure, subject to performance deductions, precludes the use of service concession classification	No balance sheet impact. Meters remain property of Energy Suppliers	3.4

2.3 Overview of some key relevant PS/QPS reporting and finance considerations

This Section summarises financial and reporting restrictions and frameworks contained in the main body of this Report. Figure 2-2 below shows a sample of PS/QPS bodies and their associated reporting frameworks, borrowing capacity, borrowing restrictions and ratio restrictions.

Figure 2-2: Public Sector frameworks and restrictions

PS/QPS body	Reporting framework	Other frameworks	Borrowing capacity	Borrowing restrictions	Ratio restrictions?	Potential Green Deal role	Section Reference
Central Government	IFRS as adapted by the FReM	European System of Accounts 1995 (ESA 95) National Accounts Budgetary	Leases Service Concessions	Loans	No	Customer	4.1
Local Government	IFRS as adapted by the Code	Prudential Code	Any facility	Set by Prudential Code	Yes	Customer (landlords or tenants) Provider/installer	4.2
NHS	IFRS as adapted by the FReM	None	Leases Service Concessions	Loans (note: FT's are not restricted)	No	Customer	4.3
Higher Education	UK GAAP SORP	None	Any facility	As set out by HEFCE	Yes	Customer	4.4
Housing	UK GAAP SORP	None	Any facility	As set by Internal covenants and the HCA	Yes	Customer (landlords or tenants) Provider/Installer	4.5
Charities	UK GAAP SORP	None	Any facility	As set out by Internal Covenants	Yes	Customer	4.6

3. Accounting for the Green Deal in PS/QPS customers

3.1 Relevant accounting frameworks and standards

3.1.1 UK GAAP, IFRS, FRSME and IFRS for SMEs

This sub-section sets out the frameworks under which PS/QPS entities in the Green Deal will have to account for their interests. The entities are required to report under IFRS as adapted for the public sector. The exception to this as at the date of this report is entities classified as Higher and Further Education, Social Housing or Charities. Rather, UK GAAP is used.

In light of these reporting frameworks and the contractual and finance structure for the Green Deal as currently envisaged by DECC, the following accounting standards are likely to be relevant, shown in Figure 3-1.

Figure 3-1

UK GAAP	IFRS
FRS 5 'The substance of transactions'	No equivalent
FRS 5 Application Note G 'Revenue'	IAS 18 'Revenue recognition'
FRS 5 Application Note F 'Private Finance Initiative and similar contracts'	IFRIC 12 'Service concession arrangements'
SSAP 21 'Accounting for leases and hire purchase contracts'	IAS 17 'Leases'
FRS 15 'Tangible fixed assets'	IAS 16 'Property plant and equipment'
FRS 25 'Financial instruments: Presentation'	IAS 32 'Financial instruments: Presentation'
FRS 26 'Financial Instruments: Recognition and measurement'	IAS 39 'Financial Instruments: Recognition and measurement'
FRS 29 'Financial Instruments: Disclosures'	IFRS 7 'Financial Instruments: Disclosures'
FRS 4 'Capital Instruments'	No equivalent
SSAP 19 'Accounting for investment properties'	IAS 40 'Investment property'

Under UK GAAP, where an entity is classified for UK GAAP accounting purposes as small or medium (the definition of an SME for accounting purposes is included in Appendix 1 "Glossary of Terms"), FRSME may be used. This framework is broadly the same as UK GAAP but is simplified to be of more relevance to smaller entities. In practical terms the key difference is a reduction to the level of disclosures required. For the purposes of this report we have assumed that the FRSME and UK GAAP result in the same accounting treatments. Under IFRS, the same applies for IFRS for SMEs. Note, however, that IFRS for SMEs is still in development.

In light of the relevant standards cited above, the next Sections look at which elements of the Green Deal are likely to be assessed using those standards, and the clauses of the standards which will have the most use.

3.2 Relevant accounting treatments

3.2.1 Accounting for executory contracts

This Section sets out accounting for executory contracts under UK GAAP and IFRS.

Currently, customer contracts for the use of energy are deemed to be executory contracts. A consideration for the Green Deal will be whether the terms constitute an executory contract going forward. Both UK GAAP and IFRS describe executory contracts as contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent. No specific standard in UK GAAP or IFRS exists which deals with executory contracts. However, the way executory contracts are accounted for falls under the 'accruals concept' for both frameworks. Executory contracts represent 'pay as you consume' arrangements. Therefore, under the frameworks, a buyer that consumes goods or services accrues a liability to pay and expenses the cost of the goods and services in the period in which they are consumed.

3.2.2 Accounting for Green Deal installations – the nature of an asset

This Section looks at the nature of an asset under UK GAAP and IFRS.

Under UK GAAP, FRS 5 'The substance of transactions' states:

"Evidence that an entity has rights or other access to benefits (and hence has an asset) is given if the entity is exposed to the risks inherent in the benefits, taking into account the likelihood of those risks having a commercial effect in practice."

No standard exists under IFRS that deals with the nature of assets specifically. However the IFRS framework defines an asset as:

"The future economic benefit embodied in an asset is the potential to contribute, directly or indirectly, to the flow of cash and cash equivalents to the entity. The potential may be a productive one that is part of the operating activities of the entity. It may also take the form of convertibility into cash or cash equivalents or a capability to reduce cash outflows, such as when an alternative manufacturing process lowers the costs of production."

Regarding fixed assets, IAS 16 'Property plant and equipment' defines tangible fixed assets:

"Property, plant and equipment are tangible items that:

- a. are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
- b. are expected to be used during more than one period."

Note that the definition under UK GAAP and FRS 15 'Tangible fixed assets' is broadly the same.

Under both sets of standards it is necessary to apply an element of judgement in assessing the existence of an asset. This means that where expenditure on assets is incurred or where new assets are introduced that are either insignificant within the context of an entity's overall balance sheet or that do not clearly and overtly fit the definition of an asset, the expenditure on those assets may be expensed in one year. Therefore an entity's existing accounting policies will impact the assessment of Green Deal installations in light of the nature of an asset as set out above.

3.2.3 Accounting for liabilities

This Section looks at the nature of a liability within the context of the Green Deal under UK GAAP and IFRS.

Under UK GAAP, FRS 5 'The substance of transactions' states:

"Evidence that an entity has an obligation to transfer benefits (and hence has a liability) is given if there is some circumstance in which the entity is unable to avoid, legally or commercially, an outflow of benefits."

No standard exists under IFRS that deals with the nature of assets specifically. However the IFRS framework defines a liability as:

“An essential characteristic of a liability is that the entity has a present obligation. An obligation is a duty or responsibility to act or perform in a certain way. Obligations may be legally enforceable as a consequence of a binding contract or statutory requirement. This is normally the case, for example, with amounts payable for goods and services received. Obligations also arise, however, from normal business practice, custom and a desire to maintain good business relations or act in an equitable manner. If, for example, an entity decides as a matter of policy to rectify faults in its products even when these become apparent after the warranty period has expired, the amounts that are expected to be expended in respect of goods already sold are liabilities.”

A key consideration in this project will be which parties to the Green Deal ultimately carry the obligation for making repayments for the installations under a range of scenarios.

3.2.4 Accounting for the substance of a transaction and service concessions

This Section sets out the accounting for the substance of a transaction and service concessions under UK GAAP and IFRS. A key consideration for the Green Deal accounting is the nature of the contracts between the Green Deal Providers, Customers and the Energy Suppliers. Under UK GAAP the relevant standard will be FRS 5 ‘Reporting the substance of transactions’. Under IFRS there is no equivalent standard but it is likely that elements of other standards will be required, such as IAS 18 ‘Revenue recognition’.

An example of the need for understanding the substance of the Green Deal involves service concessions; if it is deemed that the providers are delivering ‘assets’ to the Customers alongside the services, a service concession may exist.

Under UK GAAP, FRS 5 Application Note F ‘Private Finance Initiative and similar contracts’ is used to establish whether a service concession exists and its accounting treatment. In the Application Note the risk and reward features of the assets underlying the contract are assessed to determine which entity should recognise assets. Under IFRS, International Financial Reporting Interpretations Committee (“IFRIC”) 12 ‘Service concession arrangements’ is used. The Interpretation assesses the control features (rather than risk and reward features) of the contract to establish which entity would recognise any assets. The Interpretation applies to public to private service concession arrangements if:

- “a. the grantor controls or regulates what services the operator must provide with the infrastructure, to whom it must provide them, and at what price; and
- b. the grantor controls—through ownership, beneficial entitlement or otherwise—any significant residual interest in the infrastructure at the end of the term of the arrangement.”

Since the Green Deal can involve a public to private arrangement, where public sector entities may be party to the deal (as customers), further analysis using this standard is required. The scope of the standard requires the contract to be for the provision of infrastructure assets. These are not specifically defined in the standard but examples given include:-

- Bridges
- Tunnels
- Roads
- Schools
- Hospitals

Some characteristics of infrastructure assets are also described in the standard as being “complex, immovable, part of a system or network and without other uses”.

Both of these standards will be analysed in more detail in the subsequent sections of this report.

3.2.5 Accounting for leases

This section sets out accounting for leases under UK GAAP and IFRS. Key considerations are the potential existence and nature of any leases potentially held by parties to the deal. If it is deemed that assets exist with respect to Green Deal installations, the repayment stream for those assets may represent either operating or finance lease payments.

Under UK GAAP, SSAP 21 'Accounting for leases and hire purchase contracts' states:

"A lease is a contract between a lessor and a lessee for the hire of a specific asset. The lessor retains ownership of the asset but conveys the right to the use of the asset to the lessee for an agreed period of time in return for the payment of specified rentals. The term "lease" as used in this statement also applies to other arrangements in which one party retains ownership of an asset but conveys the right to the use of the asset to another party for an agreed period of time in return for specified payments ... A finance lease is a lease that transfers substantially all the risks and rewards of ownership of an asset to the lessee. It should be presumed that such a transfer of risks and rewards occurs if at the inception of a lease the present value of the minimum lease payments, including any initial payment, amounts to substantially all (normally 90 per cent or more) of the fair value of the leased asset. The present value should be calculated by using the interest rate implicit in the lease. If the fair value of the asset is not determinable, an estimate thereof should be used ... An operating lease is any lease other than a finance lease"

Under IFRS, IAS 17 'Leases' defines a lease, finance lease and operating lease in the same way as SSAP 21.

It is worth highlighting, in addition to these definitions that the leasing standards are under review and may be subject to change in the foreseeable future. Early indications are, for example, that lessees would be required to recognise a balance sheet item for all types of lease, be they operating or finance leases.

3.2.6 Accounting for investment properties and public sector properties

This Section sets out the accounting for investment properties and public sector properties within the context of the Green Deal under UK GAAP and IFRS.

Many landlords hold properties on their balance sheet as investment properties rather than as tangible fixed assets. Therefore their accounting treatment is subject to SSAP 19 'Accounting for investment properties' under UK GAAP and IAS 40 'Investment property' under IFRS.

SAAP 19 states:

"Investment properties should be included in the balance sheet at their open market value."

The impact of this standard means that any improvements to investment properties will not show up on the balance sheet of an investor unless the improvements result in an increase to the fair value of the property.

IAS 40 states:

"The Standard permits entities to choose either:

- a. a fair value model, under which an investment property is measured, after initial measurement, at fair value with changes in fair value recognised in profit or loss; or
- b. a cost model. The cost model is specified in IAS 16 and requires an investment property to be measured after initial measurement at depreciated cost (less any accumulated impairment losses). An entity that chooses the cost model discloses the fair value of its investment property."

The impact of this standard under IFRS means that investors have the option to elect their means of recognising investment properties. Therefore, if a cost model is elected any improvements to investment properties may be recognised on the balance sheet as additions to the assets.

Note that public sector accounting policies generally provide that public sector-owned property is held at valuation, rather than at historic cost. Therefore they are generally accounted for in the same way as investment properties under the fair value model.

3.3 Accounting for the Green Deal in PS/QPS owner-occupiers

This section looks at accounting for the Green Deal from the perspective of PS/QPS owner/occupiers. The public sector follows IFRS as adapted for the public sector. Quasi-public sector entities such as higher education, social housing and charities use UK GAAP. In this section we have assumed that all PS/QPS entities are owners of their properties.

Note that there is a range of additional public sector considerations which requires scrutiny. Considerations include, for example, the impact of budgetary versus financial accounting in the public sector, which follow potentially different accounting standards. Detailed discussion on public sector specifics is contained in Section 4.

3.3.1 Accounting for current energy consumption

At present, PS/QPS entities pay for their energy consumption via executory contracts. A consideration for the Green Deal will be whether the terms constitute an executory contract going forward. Both UK GAAP and IFRS describe executory contracts as contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent. No specific standard in UK GAAP or IFRS exists which deals with executory contracts. However, the way executory contracts are accounted for falls under the 'accruals concept' for both frameworks. Executory contracts represent 'pay as you consume' arrangements. Therefore, under the frameworks, a buyer that consumes goods or services accrues a liability to pay and expenses the cost of the goods and services in the period in which they are consumed.

3.3.2 Accounting for the Green Deal installation

After the implementation of the Green Deal there is a range of accounting consequences to the terms of the deal which have an effect on PS/QPS customers. This Section discusses the range of accounting considerations for the treatment of the installation works only. The treatment of the ongoing energy consumption is discussed later in Section 3.3.3.

(i) The existence and nature of an asset

Under current Green Deal proposals customers will receive a Green Deal installation package which constitutes physical upgrades to their premises. The upgrades represent measures to reduce overall energy consumption and consequently reduce costs for the customer. Under both UK GAAP and IFRS definitions the upgrades represent an asset since the customer has access to the benefits (reduction to the cost of their energy bill) associated with the upgrades, and the access and benefits extend to more than one annual period.

Using the fixed asset definitions from Section 3.2.3 in their purest form would lead to a customer capitalising the Green Deal installation as a fixed asset on its balance sheet, since it is a tangible item expected to be used for more than one period. The fixed asset would be depreciated over the useful economic life of the installation. However, fixed asset recognition is not necessarily practical given that the value of the installation may not be material to the customer's overall balance sheet. In addition, their accounting policy may not include detailed componentisation of parts of assets or may not permit the capitalisation of items under a certain value. In these cases it may be appropriate to write the expenditure off to the income statement in the same year. Hence PS/QPS customers should be guided by their accounting policies and materiality considerations.

Note that public sector entities usually carry their properties at current cost, rather than as fixed assets measured at historic cost. This means that the value of a property on the balance sheet is shown at the open market value (usually determined annually) as opposed to the value at which it was bought, less any depreciation incurred to date. Therefore, where PS/QPS entities account for their properties as investment properties, an addition to fixed assets can only be carried through to the following balance sheet period if the Green Deal installation results in an uplift to the value of the property on the open market. If a valuation uplift cannot be established it may be appropriate to write off the installation works as an expense to income statement. This means that if a PS/QPS entity undergoes a Green Deal installation, and at the end of the year the value of the property on the open market is the same as before the installation, the cost of the installation will be charged to the income statement rather than capitalised as an asset on the balance sheet.

(ii) The existence of a liability

In the Green Deal, PS/QPS customers will receive an installation package and will make repayments over a period of time to the Green Deal Provider (via the Energy Suppliers). Key considerations will be whether this represents a liability to the customer and what type of liability may exist. Using the UK GAAP and IFRS definitions cited in Section 3.2.4, it appears that the customer has a measurable, present and contractual obligation to make repayments, resulting from a past event; entering into the Green Deal contract. Therefore a liability would be recognised by the customer and would be amortised as repayments are made. However, a question arises as to the impact of the 'association' of the liability; the installation and the liability are associated with the property and the meter rather than with the customer. The customer, upon relinquishing the property, is no longer liable to make repayments. Rather, the new property occupier would take them on. While this does reduce clarity on this issue, it is unlikely to alter the outcome since a sale of the property represents a passing on of the contractual obligations to the new occupier. The purchase of that same property represents entrance into the existing contractual obligations to make repayments.

We understand the exact terms of the mechanism are as yet undecided. Therefore, the final payment mechanism in the Green Deal may have some impact; if the repayments for installations are on a fixed basis the liability is reliably measurable and hence a liability may be recognised. However, if the repayment terms link repayments to some kind of variable index or, say energy consumption, then it may become difficult to reliably measure the outstanding amount due. In the event that the scale or repayments cannot be reliably measured the standards in both UK GAAP and IFRS do not permit the recognition of a liability.

Any liability recognised by an entity may carry an associated finance cost which should be spread systematically through the income statement over the period during which repayments are made. Therefore, if the terms of the Green Deal permit the option for early repayment of the installation costs, and that option is taken up, customers may have to adjust the income statement impact of any subsequently altered finance costs. Note that customers may include in the notes to their accounts a section on the nature of liabilities recognised as a result of the Green Deal, as distinct from a standard loan arrangement.

(iii) The existence of a lease

In the Green Deal customers will receive an installation package in return for the promise to make fixed repayments to the Energy Suppliers over a period of time. It is possible that this represents a lease, particularly under IFRS which contains the concept of an embedded lease. However, the definitions cited in Section 3.2.5 state that a lease can only be present if the lessor, in this case the Green Deal Provider, retains legal ownership of the installation package. In the Green Deal it is our understanding that this is not the case; neither the financial institutions nor the Green Deal Providers retain legal ownership of the installation packages once they are installed. Therefore a lease does not exist.

(iv) The existence of a service concession

UK GAAP

Under UK GAAP FRS 5 Application Note F ("ANF") deals with accounting for PFI contracts. These usually involve a public sector to private sector arrangement. This Application Note is relevant to such contracts.

The table in Figure 3-2 assesses whether the Green Deal is within the scope of FRS 5 ANF.

Figure 3-2: Scope of FRS 5 ANF

Feature	Relevance to the Green Deal
A contract to provide services is awarded by the purchaser to the operator. The contract will specify the level of service required over the period of the contract. Usually, the contract also provides for a single ("Unitary") payment to be made in each period, linked to factors such as availability, performance and levels of usage.	No relevance - The terms of the Green Deal are unsigned as at the date of this report. However, we understand the current thinking is that the contract will be for the provision of an installation package only, and that any maintenance works carried out subsequent to the initial installation would be as part of a warranty taken out with the package. The repayments made by customers will not incur deductions for failures in performance. Rather, any failures to the installations would be repaired under warranty and for no charge.

	In addition, maintenance works are not likely to be cited in the contract as a 'specified level of service' as is normally the case for a vanilla service concession arrangement; the pivotal delivery of the Green Deal is that of the initial installation, rather than output specified services. To the extent that these elements change such that a specified level of service is stipulated with payment deductions possible for performance failures, this feature may become relevant to the Green Deal.
A property, which is legally owned by or leased to the operator, will usually be necessary to perform the contracted service. Under the contract, the operator will typically design, build, finance and operate the property. The contract may specify features or standards required of the property, for example, in order to satisfy statutory obligations of the purchaser.	Some relevance - The Green Deal Provider would be designing, financing and maintaining the installation assets.
The contract will specify arrangements for the property at the end of the contract term (which may include various options available to one or both parties).	Unknown – at present it is unknown what the duration of the contract will be or if there will be any specified hand back procedures. For the domestic market we would expect the maintenance of the installation to be indefinite and ongoing. To the extent that these elements change this feature may become relevant to the Green Deal.
As a public sector body, the purchaser is required to demonstrate that the involvement of the private sector offers value for money when compared with alternative ways of providing the services. This is generally achieved by a transfer of risk from the public to the private sector.	Some relevance – some risk is transferred, but value for money over and above in-house delivery will be hard to establish since this is a new initiative.

The analysis above suggests the project shows some characteristics of a service concession and has elements which fall into the scope of FRS 5 ANF. However, on balance and as shown in Figure 3-2, there are not enough facets to the Green Deal which would permit the use of FRS ANF as a means of accounting for the deal. No service concession exists under UK GAAP.

IFRS

As part of the installation package, the Green Deal Providers are tasked with performing planned and reactive maintenance services on the installations. This, for example, could be upgrades to a boiler system and could constitute some major replacement works. This means that the public sector entity could be making payments in return for the provision of assets and services. Therefore it may be necessary to identify or rule out the existence of a service concession under IFRS in this arrangement.

Under IFRS, IFRIC 12 deals with service concession arrangements. As noted previously in section 3.2, the Interpretation applies to public to private service concession arrangements if:

- “a. the grantor controls or regulates what services the operator must provide with the infrastructure, to whom it must provide them, and at what price; and
- b. the grantor controls—through ownership, beneficial entitlement or otherwise—any significant residual interest in the infrastructure at the end of the term of the arrangement.”

Since the Green Deal in this instance involves a public to private arrangement further analysis using this standard is required. The scope of the standard requires the contract to be for the provision of infrastructure assets. These are not specifically defined in the standard but examples given include:

- Bridges
- Tunnels
- Roads
- Schools
- Hospitals

Some characteristics of infrastructure assets are also described in the standard as being “complex, immovable, part of a system or network and without other uses”.

An average Green Deal installation package does not immediately show congruence to these examples or characteristics. However, when considering, say, a large scale boiler installation in a hospital, the sheer size of the investment, network of assets and complexity of such an installation may be within the standard’s scope and would need to be considered in greater detail.

The terms of the Green Deal are unconfirmed as at the date of this report. However, the current thinking is that the contract will be for the provision of an installation package only, and that any maintenance works carried out subsequent to the initial installation would be as part of a warranty which is taken out as part of the package. The repayments made by the public sector will not incur deductions for failures in performance. Rather, any failures to the installations would be repaired under warranty and for no charge.

In addition, maintenance works are not likely to be cited in the contract as a ‘specified level of service’ as is normally the case for a vanilla service concession arrangement; the pivotal delivery of the Green Deal is that of the initial installation, rather than the output specified services.

Therefore it is fair to say that there are no services specified in the contract, only assets and a warranty. To the extent that these elements change such that a specified level of service is stipulated with payment deductions possible for performance failures, this feature may become relevant to the Green Deal. In that instance the criteria a) and b) above would require assessment; the public sector would need to control or regulate the services as stipulated in the criterion a) and would need to control the residual interest in the assets at termination as stipulated in criterion b). Only then could a service concession accounting treatment be used.

3.3.3 Accounting for energy consumption after the Green Deal installation

The previous section dealt with the accounting consequences of the Green Deal installation package on the balance sheet of a PS/QPS customer. Alongside the installation repayments, customers will continue to make payments for their ongoing energy consumption. Payments are made based on the accrued costs of energy consumption and are clearly separable from the repayments made for the installation works, since their scale and timing are the consequence of separately assessed activities. This means that the payments for energy consumption can be stripped out of the analysis made in the previous section.

Customers will continue to pay as they consume energy and account for the expenditure in the corresponding period. This follows the accruals concept discussed in Section 3.2.2 and is the same under both UK GAAP and IFRS. There is no effect on the annual balance sheet of a customer other than the measurement and recognition of any unpaid accrued energy costs at the end of a given period.

3.3.4 Accounting for energy meters

Current industry practice dictates that the installation of meters in properties does not constitute the delivery of an asset for the property. Legal ownership rests with the energy company and meters are accounted for as a maintenance tool. Subsequent maintenance costs incurred in the upkeep of energy meters is accounted for as a cost to the energy company’s income statement. There is no balance sheet impact for the customer.

3.4 Accounting for the Green Deal in PS/QPS tenants

This section looks at accounting for the Green Deal from the perspective of PS/QPS entities which are tenants in their properties and which are directly responsible to Energy Suppliers for their energy bills.

3.4.1 Accounting for current energy consumption

At present, PS/QPS tenants pay for their energy consumption via executory contracts. This means that they account for their energy consumption as set out in Section 3.3.1.

3.4.2 Accounting for the Green Deal installation

After the implementation of the Green Deal there is a range of accounting consequences to the terms of the deal which have an effect on PS/QPS tenants. This Section discusses the range of accounting considerations for the treatment of the installation works only. The treatment of the ongoing energy consumption is discussed later in Section 3.4.3.

(i) The existence and nature of an asset

In the Green Deal, PS/QPS tenants will receive a Green Deal installation package which constitutes physical upgrades to their premises. Aside from the value of the investment, the terms of the PS/QPS Green Deal installation package for tenants are the same as for PS/QPS owner-occupiers. Therefore the accounting treatment is expected to be broadly the same. However, there is a key distinction to be considered involving leasing. If a PS/QPS entity is renting its property via a finance lease or operating lease it may be appropriate to recognise the installation works as a leasehold improvement within tangible fixed assets. This will, again, be guided by the entity's accounting policies and materiality issues as discussed in section 3.3.2. In addition, in the event that a leasehold improvement is recognised, the standards indicate that a PS/QPS tenant should depreciate the installation works over the shorter of the useful economic life of the installation and the remaining life of the lease. However, depreciation terms are open to discussion to reflect the true economic substance of the assets' use. If a more reasonable depreciation policy can be established the standards do not preclude its use. Note that where PS/QPS tenants account for their properties as investment properties, an addition to fixed assets can only be carried through to the following balance sheet period if the Green Deal installation results in an uplift to the value of the property on the open market. If a valuation uplift cannot be established it may be appropriate to write off the installation works as an expense to income statement.

(ii) The existence of a liability

In the Green Deal PS/QPS tenants will receive an installation package in return for the promise to make fixed repayments to the Energy Suppliers over a period of time. A key consideration will be whether this represents a liability. Since the terms of financing are the same as those of the PS/QPS owner-occupiers, and using the UK GAAP and IFRS definitions cited in Section 3.2.4, it appears that the tenants should account for the installation package in the same way as PS/QPS owner-occupiers as discussed in section 3.3.2; a liability is recognised. A distinction worth noting, however, is that if a PS/QPS tenant breaks its tenancy agreement the installation works and associated liability are derecognised and passed on to the property's landlord or the new tenant (i.e. a liability to the PS/QPS during the void period, until passed on to the new tenant).

(iii) The existence of a service concession

As part of the installation package, the Green Deal Providers are tasked with performing planned and reactive maintenance services on the installations. This, for example, could be upgrades to a boiler system and could constitute some major replacement works. This means that the PS/QPS entity could be making payments in return for the provision of assets and services. Therefore, it may be necessary to identify or rule out the existence of a service concession in this arrangement.

Since the terms of the Green Deal are the same for PS/QPS tenants as they are for PS/QPS owner occupiers, the accounting treatment with respect to service concession considerations is likely to be the same as discussed in Section 3.3.3. No service concession exists under UK GAAP or IFRS under the currently expected terms of the deal.

3.4.3 Accounting for energy consumption after the Green Deal installation

This section looks at the treatment of energy consumption in PS/QPS tenants. Since the terms of supply are the same for PS/QPS tenants and PS/QPS owner occupiers the accounting for the energy consumption is same as discussed in section 3.3.4, under both UK GAAP and IFRS. There is no effect on the annual balance sheet of a PS/QPS tenant other than the measurement and recognition of any unpaid accrued energy costs at the end of a given period.

4. Overview of some key relevant PS/QPS reporting and finance considerations

4.1 Central Government Departments

This section deals with the financial and reporting restrictions on Central Government Departments and their Agencies.

4.1.1 Borrowing restrictions

Central Government Departments are not permitted to enter into direct loan arrangements. Rather, they are able to enter into leasing and service-type contracts, such as executory contracts, leases and service concession arrangements. Therefore, if the Green Deal either has the substance of a loan, or the legal form of a loan, this is likely to preclude Departments and Agencies from participating. Any Green Deal contract terms with a Central Government Department would need to meet the parameters (set out in the Accounting Report) of a lease or service concession.

4.1.2 Central Government books and records

Central Government keeps three sets of books and records:

- **National Accounts framework** - used to define and measure government's fiscal policy. The key outputs are a set of economic statistics including the measurement of the overall size of the economy (i.e. Gross Domestic Product), and within that the size of the public sector. HM Treasury use these statistics to determine the budgetary constraints.
- **Budgetary framework** - used to allocate and control the overall amount of available public spending, determining how much of the budget an individual department can access and how specific types of transactions are treated within that limit; and
- **Financial accounting framework** - used to report the activity of individual public sector organisations based on commercial accounting concepts.

This section comments on the National Accounts and the Budgetary Frameworks. It is relevant to understand the key agents involved in managing the public finances through these frameworks. This is set out in Figure 4-1 below:

Figure 4-1 - Managing the public finances – key agents

Office for Budgetary Responsibility	HM Treasury	Office for National Statistics	Parliament
• Key macro-economic forecasts • Updated for policy measures • Politically independent • Temporary board and secretariat • To be established in legislation idc	• Sets fiscal policy objectives • Allocates expenditure envelopes through the Spending Review process • Monitors performance of overall budget on day-to-day basis	• Independent, non-Ministerial government department • Prepares outturn statistics only • Follows the European System of Accounts 1995 • Eurostat collates and checks returns from the ONS for EU fiscal monitoring	• Votes on public spending by departments • Scrutiny role over HM Treasury decisions and ONS/OBR performance • National Audit Office reports to Parliament – NAO audit government departments

4.1.3 Introduction to the National Accounts

The National Accounts are a system of accounts that are used to measure, in an internationally comparable fashion, a nation's economic activity. Within the European Union, they are produced in accordance with the standards set out in the European System of Accounts 1995 ("ESA95")¹. In the UK, the Office for National Statistics ("ONS"), a Non-Ministerial Government Department, is responsible for producing the National Accounts free from political intervention.

ESA95 provides an entity, asset, liability and transaction classification system. Key outputs from the system of National Accounts include:

- Gross Domestic Product ("GDP") statistics – which measure the value of output of the whole economy; and
- Public Sector Finances ("PSF") statistics – which are the series of economic statistics relating to the activity of the public sector covering receipts, expenditures, borrowing and debt.

While ESA95 has similarities to IFRS, which individual public sector bodies use to prepare their own financial statements, there are some significant differences. For example the treatment of certain liabilities, definitions of capital spending (specifically in respect of military equipment) and, potentially of direct relevance to the project, judgements around who controls an entity, can vary under the two frameworks.

4.1.4 Implications for the Green Deal

Upon implementation of the Green Deal Central Government Departments will need to consider their interest in the deal against relevant parts of National Accounts framework.

4.1.5 Budgetary policy

As highlighted above, within the budgetary framework there are specific types of transactions, different types of spending, and spending limits associated with each. Figure 4-2 below seeks to summarise the different budgetary headings by showing how sample transactions would be recorded. DEL is the commonly used acronym for 'Departmental Expenditure Limit' with AME meaning 'Annual Managed Expenditure' in the context of public sector expenditure.

¹ <http://circa.europa.eu/irc/dsis/nfaccount/info/data/ESA95/en/esa95en.htm>

Figure 4-2: Budgeting policy – sample transactions

	Resource budget	Capital Budget
DEL	• Wages and consumption of goods and service • Current grants • Current income as per consolidated budgeting guidance • Current spending financed from provisions • Profit/losses on disposal • Depreciation and impairments that represent consumption of capital	• Capital asset acquisitions/ disposals • Capital grants • Net lending (inc. certain large prepayments/debtors) • Capital spending financed by provisions
AME	• Take up and release of provisions • Impairments that are effectively price movements • Take up, spending against, and release of AME provisions	As above but AME programmes

4.1.6 Implications for the Green Deal

Central Government Departments entering into the Green Deal will need to consider how the associated payments are recorded in the budgetary framework.

4.1.7 PPP/PFI/Outsourcing/Service concessions – Key considerations

Generally the National Accounts, budgetary treatment and financial accounting treatment align. However, there are a number of instances where this is not the case and the treatment is “de-coupled” with respect to service concessions.

Accounting for PPP/PFI/Outsourcing arrangements, i.e. service concessions is impacted by the decoupling described in Section 4.1.3. Figure 4-3 below sets out the four key pieces of guidance under which such arrangements can be assessed.

Figure 4-3: Decoupling accounting and budgeting

Decoupling accounting and budgeting				
The expectation is that many deals will come on balance sheet. For Central Government and NHS bodies, there is expected to be a decoupling of accounting and budgeting treatment for the reasons described below.				
Eurostat - ESA 95	TTF TN1	FRS 5 Note F	IFRS based FReM	IFRIC 12
Risk Under ESA 95 does not count towards net debt control totals and capital budget provided the Operator bears: • Construction risk plus • Availability risk or • Demand risk.	Risk Detailed description of risks and defined approach to analysis Quants basis, considers risk range and can lead to minimisation of demand and residual value risk	Risk Substancebased approach No requirement for quants model Considers quantum of demand and residual value risk	Control In scope for Operator if Grantor: • Controls asset use and residual interest where this is significant or • Controls his asset use and residual interest is not significant If in scope, not TFA/PPE, but financial asset or intangible asset depending on contractual rights to receive cash.	Control – Symmetry Requirement for public sector to record as TFA/PPE if inside scope of IFRIC 12. HMT definition of what is assessed under IFRIC 12 is broad– includes noncurrent assets used for admin purposes.

Under UK GAAP (FRS 5 Note F and the Treasury Taskforce Technical Note 1 (“TTF TN1”) which provided an interpretation to FRS 5 Note F for certain parts of the Public Sector) the accounting for the underlying assets (and liabilities) within a service concession arrangement was based on an assessment of risk and reward with respect to those assets and any non separable service provision. This approach was consistent with the requirements of ONS with respect to preparing the National Accounts in line with the Eurostat – ESA 95 rules.

With the transition to IFRS from 1 April 2009 the relevant financial accounting test was based on the HM Treasury interpretation of IFRIC 12 for use by the Public Sector grantor. This is based on a test of control with respect to the contract and the underlying assets in the contract. Although the ONS made no comment on this approach in relation to the financial accounting and the preparation of financial statements, their view is that a control based approach is not appropriate for National Accounts purposes. As result we have seen a “decoupling” of the financial accounts and National Accounts and now the budgetary treatment follows the National Accounts treatment.

The result of the National Accounts treatment is that the underlying assets (and liabilities) in many PPP/PFI/outsourcing arrangements (service concession) are now on balance sheet for financial accounting and preparation of financial statement purposes. However the arrangements are not recorded as part of the National Accounts debt liability and do not require capital budget cover. This has been described as an “on balance sheet, but off National Accounts debt and off capital budget” treatment.

4.1.8 Implications for accounting for the Green Deal

If Green Deal arrangements are set up and classified as service concessions, the IFRS financial accounting may result in an on balance sheet treatment. However, for budgetary and National Accounts purposes, the analysis under EAS 95 rules may result in a revenue budget classification, which is akin to an off balance sheet treatment.

4.2 Local Government

This section deals with some of the key financial and reporting restrictions on Local Government Bodies, and draws on the following guidance:

- Prudential Code Framework 2009
- Chartered Institute of Public Finance and Accountancy (“CIPFA”)
- The Code 2010

4.2.1 Borrowing restrictions and ratios

Local Government Bodies (“Authorities”) can enter into loan arrangements by using their prudential borrowing powers (“Prudential Borrowing”). They can also enter into executory contracts, leases and service concession arrangements. The latter two also have implications on an Authority’s Prudential Borrowing and on their Capital Financing position, (which ultimately leads to council tax bill reconciliations). Therefore, when considering the Green Deal in Local Government it is important to understand the Prudential Borrowing Regulations and Capital Financing Framework.

4.2.2 Books and records

Local Government keeps financial statements prepared under IFRS as adapted by the Code from 1 April 2010, and a set of ratios prepared under the Prudential Borrowing Framework/Capital Financing Requirements.

For completeness it is important to note that local government entities also include a variety of reserves in their financial records. These reserves include the Housing Revenue Account (“HRA”). We have not provided detail on the HRA because this is currently under review as part of the Localism Bill. If the Green Deal is proposed with respect to a local authority’s general needs housing stock, then the HRA rules will also need to be considered. Given that some form of liability is likely to need to be recognised, even if this is only with respect to the voids period as explained at 3.4.2 (ii), consideration will need to be given to any limitations placed on the level of HRA related borrowings.

4.2.3 The Prudential Code and related statutory requirements

The Prudential Code Framework 2009 (“Prudential Code”) covers a range of statutory provisions and professional requirements that broadly allow Authorities to determine their own plans for capital investment, subject to the Authority following due process in agreeing these plans and being able to provide assurance that they are prudent, affordable and sustainable:

- The general legal environment within which an Authority operates requires that it acts reasonably and with prudence in the exercise of their statutory powers;
- Authorities must devise their capital programmes within the bounds of the statutory provisions, having regard to:
 - the Prudential Code - effectively a contract between Central and Local Government that provides the necessary assurance that an Authority will apply the flexibilities and freedoms responsibly and prudently and by applying a due process to the setting of budgets, limits and indicators;
 - financial accounting practices – wherever possible, reliance is placed on Local Government financial accounting requirements to determine how expenditure is to be identified and the period in which it should be charged;
 - standards of governance – in their work under the framework, members will be guided by codes of conduct and officers by their relevant professional standards.

4.2.4 Prudential Borrowing Code indicators

The CIPFA Prudential Code for Capital Finance in Local Authorities was introduced in 2004. CIPFA is currently undertaking a review of the implementation and ongoing use of the Prudential Code to assess whether there are improvements that could and should be made. These notes are based on the current system of indicators as established in the 2004 Code as at the date of this Report.

The Prudential Code sets out the indicators that must be used, and the factors that must be taken into account. The prudential indicators required by the Code are designed to support and record local decision making. They are not designed to be comparative performance indicators.

In setting or revising their prudential indicators, the Authority is required to have regard to the following matters:

- Affordability, e.g. implications for Council Tax and Council housing rents;
- Prudence and sustainability, e.g. implications for external borrowing;
- Value for money, e.g. option appraisal;
- Stewardship of assets, e.g. asset management planning;
- Service objectives, e.g. strategic planning for the authority; and
- Practicality, e.g. achievability of the forward plan.

An Authority must consider the affordability of its capital investment during all the years in which it will have a financial impact on the Authority. In considering the affordability of its capital plans, an Authority is required to consider all of the resources currently estimated as being available to it for the future, together with its capital plans, income and expenditure forecasts for the forthcoming two years.

An Authority's prudential indicators are prepared on the basis of the Authority as a standalone entity rather than the Authority as a group of entities. The Authority should consider preparing local indicators showing the full implications of its borrowings based on its group of interests.

As stated above, we have not provided detail on the HRA because this is currently under review as part of the Localism Bill. If the Green Deal is proposed with respect to a local authority's general needs housing stock, then the HRA rules will also need to be considered. This would include considering any limited placed on the level of HRA related borrowings.

4.2.5 Implications for accounting for the Green Deal

The potential accounting treatment for Authorities is included as part of in Section 3 of the Accounting Report. It is possible that Authorities would recognise either a loan or a service concession to reflect their entering into a Green Deal contract. In this instance the Authority would register the liability as Prudential Borrowing.

The Authority's use of the Prudential Code will have an impact on a number of prudential indicators. Subject to specific analysis these may show that the Authority will be committing a greater proportion of its projected revenue resources to meeting interest and Minimum Revenue Provision ("MRP") payments that it has had to hitherto.

4.2.6 Capital Expenditure

In England, the Local Government 2003 Act is supported by the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (SI 2003 No 3146).

Unless expenditure can be classified as capital expenditure under any of the three routes allowed by legislation it will be charged to revenue in the year that the expenditure is incurred. If expenditure meets the definition then it can be met by prudential borrowing or from capital receipts. In considering the Green Deal it is worth noting that there are three routes by which expenditure can qualify as capital are shown in Figure 4-4 and explored in this Section:

Figure 4-4: Capital qualification routes

Route 1 - The expenditure results in the acquisition, construction or enhancement of fixed assets (tangible and intangible) in accordance with “proper financial accounting practices”	Section 16 of the Local Government Act 2003 specifies that the definition of capital expenditure comprises these three descriptions of expenditure. Regulation 29A of the 2003 Capital Financing Regulations (England) then exempts these three categories of expenditure from being charged to revenue. Regulations 31 (England) define proper accounting practices as those contained in the local authority SORP.
Route 2 - The expenditure meets one of the definitions specified in regulations made under the 2003 Act	
Route 3 - The Secretary of State makes a direction that the expenditure can be treated as capital expenditure	

4.2.7 Route 1 - Capitalisation determined with regard to accounting practices

Local government legislation requires local authorities to account under the accounting frameworks detailed in the Accounting Report.

The basic provisions are that expenditure can be capitalised where it relates to the:

- Acquisition, reclamation, enhancement or laying out of land.
- Acquisition, construction, preparation, enhancement or replacement of roads, buildings and other structures.
- Acquisition, installation or replacement of movable or immovable plant, machinery, apparatus, vehicles or vessels.

Subsequent expenditure on an asset is capitalised using the same criteria as the initial spend. The new expenditure is reviewed as to whether it is probable that the future economic benefits associated with the spend will flow to the entity and the cost can be measured reliably. It is not necessary for the expenditure to improve the condition of the asset beyond its previously assessed standard of performance; the measurement is against the actual standard of performance at the date of expenditure.

4.2.8 Route 2 - Capital Expenditure Defined by Regulation (England)

Special arrangements exist in local government for the Secretary of State to extend the definition of capital expenditure for one of two purposes:

- To recognise that some of the expenditure incurred by an authority has a wider lasting public benefit than is reflected in the accounting rules for fixed assets.
- To provide a disincentive for authorities to enter into certain transactions that would not otherwise have expenditure implications per the accounting rules.

4.2.9 Route 3 – Secretary of State direction

The Secretary of State can make an overriding direction that deems the expenditure treated as capital expenditure.

4.2.10 Minimum Revenue Provision

Authorities have to recognise a provision to repay any loan received through the Authority's general fund using a mechanism known as the MRP. There are different approaches to determining MRP. Historically, Authorities have had to set aside a defined amount (often taken as 4%) for the repayment of loan debt principal. MRP is set by reference to regulations issued under the Local Government Act 2003. New arrangements were introduced in March 2008 which provide for flexibility in the determination of how the MRP is calculated. The new MRP system is based on non-statutory guidance rather than legislation and the legal requirement is simply stated. Effectively Authorities are expected to make prudent provision for the sums set aside for repayment of debt, meaning that council tax payers need to be charged for the costs of service delivery and one of these costs is the financing of capital items needed to deliver that service.

4.2.11 Implications for accounting for the Green Deal

It is likely, subject to further analysis, that Green Deal contracts taken up and registered as liabilities in local government will result in a c.4% charge via the Capital Finance Regulations.

4.2.12 Other potential Green Deal roles in local government entities

Subject to further consultations and legal advice, it is possible that a local government entity could take on the role of a Green Deal provider. This could mean that the entity would provide some of the financing.

Also, many local government entities have direct labour forces, or related companies formed from their direct labour force. These could be utilised as green deal installer.

For the avoidance of doubt the scope of this report is principally to consider a local government body as the recipient of a Green Deal. While, we highlight these other potential roles, detailed consideration of these roles is outside the scope of our report. For a local government body to take on these other roles would be a commercial decision for which they would have to undertake their own due diligence.

4.3 NHS Bodies

This section deals with some of the key financial and reporting restrictions on NHS bodies.

4.3.1 Borrowing restrictions

In relation to NHS Bodies it is necessary to distinguish between NHS Foundation Trusts ("FTs") and other NHS Trusts and Primary Care Trusts ("PCTs"). In addition, current NHS structures are under review. The relevant government white paper proposes the abolition of Strategic Health Authorities and PCTs, with the creation of GP Commissioners in their place. The paper does not significantly alter NHS Trusts or FTs. Note that since the revised NHS structure is still under review we have not considered the new structure in the remainder of this Section.

4.3.2 Foundation Trusts

FTs have the power to enter into loan arrangements, using their prudential borrowing capacity. However, before any borrowing is permitted, the extent of the capacity (which is reasonably limited) is reviewed, set and approved by their independent regulator, Monitor. In addition, FT's borrowing capacity is identified based on ratio calculations. We would be happy to provide further information on these.

4.3.3 Other NHS bodies

Other NHS Trusts and PCTs cannot enter into loan arrangements. They are able to enter into executory contracts, leases and service concession arrangements. Therefore, if the Green Deal has either the substance of a loan or the legal form of a loan this is likely to preclude NHS Trusts and PCTs. Any Green Deal contract terms with NHS Trusts and PCTs would need to meet the parameters (set out in the Accounting Report) of a lease or service concession.

4.3.4 Books and records

The Department of Health which has overall responsibility for the NHS, faces the same financial accounting, National Accounts and budgeting frameworks as described for any Central Government Department in Section 4.1. However, currently the Department of Health does not entirely cascade the National Accounts and budgeting framework down to individual NHS Bodies. Therefore the issues around decoupling with respect to service concessions and sector classification issues are not currently relevant at a Trust level in the NHS.

4.4 Higher Education Institutions

This section deals with the financial and reporting restrictions on Higher Education (“HE”) institutions.

4.4.1 Borrowing restrictions and ratios

HE institutions (including universities) have the power to borrow and are also able to enter into executory contracts, leases and service concession arrangements. However, the Higher Education Funding Council in England (“HEFCE”) sets restrictions on the level of financial commitments a university can make. Certain ratios are set which govern when consent is required from HEFCE before a financial commitment can be made. These are set out in the ‘Model Financial Memorandum between HEFCE and institutions, Annex F: Consent for Financial Commitments’.

Dependent on the factors described below, a university is required to obtain written consent from HEFCE before it takes out any long-term financial commitment:

- where an institution is informed that it is ‘at higher risk’;
- where its total financial commitments would exceed 50 per cent of income (gearing);
- where the ratio of net operating cash flow to capital and interest payments is below 1.5 (cash debt service cover); or
- where the ratio of net operating cash flow to interest payments is below 2 (cash interest cover).

Loans, finance leases and service concession arrangements are specifically defined as long-term financial commitments by HEFCE.

4.4.2 Books and records

As set out in Section 4.1 the HE Sector currently reports under UKGAAP as adapted by their SORP. There is a possibility that the HE Sector will adopt International Financial Reporting Standards for Small and Medium-sized Entities (“IFRS for SMEs”) for 2013/14.

4.5 Social Housing

This section deals with some of the key financial and reporting restrictions on Social Housing entities.

4.5.1 Borrowing restrictions and ratios

Social Housing providers have the legislative power to borrow and are also able to enter into executory contracts, leases and service concession arrangements. However, they are subject to regulation and review by a variety of bodies including, for example, the Homes and Communities Agency and the National Housing Federation. A key consideration in any monitoring review is financial standing, including ratio analysis. Also, a large number of Social Housing providers have debt from the major financial institutions. In securing and maintaining this debt there are a range of covenant measures, including balance sheet, income and expenditure and cash flow ratios which need to be met and any impact on these needs to be considered.

4.5.2 Books and records

As set out in Section 4.1 the Social Housing Sector, which for the purposes of this Report includes Housing Associations/Registered Social Landlords, reports under UKGAAP as adapted by their SORP. There is a possibility that the Social Housing Sector will adopt International Financial Reporting Standards for Small and Medium-sized Entities (“IFRS for SMEs”) from 2013/14.

4.5.3 Other potential Green Deal roles in Social Housing entities

Subject to further consideration, including legal advice, Social Housing entities could take on the role of financiers and/or installers for the Green Deal.

4.6 Charities

This section deals with some of the key financial and reporting restrictions on charity entities. The charity sector is regulated by the Charity Commission, which, given the large number of charitable organisations in the UK, has limited involvement in the day-to-day regulation. Its main role relates to the SORP process for charities.

4.6.1 Borrowing restrictions and ratios

Charities are generally able to enter into executory contracts, leases and service concession arrangements. Equally, charities may have the power to borrow. Their powers are very much dependent on what is included in the legal documentation surrounding individual charities' set up and operations.

The Charities Act 2006 extended the powers that charities have to invest funds and to borrow. With respect to their property, many charities now have considerable freedom to borrow.

A key issue is the legal nature of the charity. Charities which are constituted by trust deed will also need to look carefully at their legal powers, and potentially seek legal advice, before entering into any form of borrowing. For other forms of charities it is likely to be more straightforward. The Charity Commission has a range of guidance on its website around this area, including proforma trust deeds. Finally, the attitude of the charity's trustees or board is likely to be highly relevant in this area.

4.6.2 Books and records

As set out in Section 4.1 the Charity Sector reports under UKGAAP as adapted by their SORP. There is a possibility that the Charity Sector will adopt IFRS for SMEs from 2013/14.

Appendix 1 - Glossary of Terms

Green Deal Specific Terms

Green Deal	The Green Deal will be a market mechanism, funded by private capital and implemented by private sector market participants, which DECC believes will enable a revolutionary programme improving the energy efficiency of Britain's building stock and delivering savings to energy customers.
Green Deal Provider	The possible roles of the Green Deal Provider include: (i) Assessment of the property for the purposes of the Green Deal, although this may be carried out by the Green Deal Providers themselves, by a subcontractor to the Green Deal Provider or by another independent Accredited Assessor; (ii) Installation of the recommended measures for that property, which may be carried out by the Green Deal Providers themselves, by a subcontractor to the Green Deal Provider or by another independent Accredited Installer; (iii) Planned and reactive maintenance services on the installations, which may be carried out by the Green Deal Providers themselves, by a subcontractor to the Green Deal Provider or by another independent Accredited Installer; and (iv) Financing of the assessment and installation of the recommended measures. The customer's main contractual relationship is expected to be with Green Deal Provider.
Green Deal Agent	The possible roles which a Green Deal Provider may carry out via a Green Deal Agent include: (i) Assessment of the property for the purposes of the Green Deal, although this may be carried out by the Green Deal Agents themselves, by a subcontractor to the Green Deal Provider or by another independent Accredited Assessor; (ii) Installation of the recommended measures for that property, which may be carried out by the Green Deal Agent themselves, by a subcontractor to the Green Deal Provider or by another independent Accredited Installer; and (iii) Planned and reactive maintenance services on the installations, which may be carried out by the Green Deal Agents themselves, by a subcontractor to the Green Deal Provider or by another independent Accredited Installer.
Green Deal measures	The Green Deal measures are the physical equipment and building alterations which may be installed in a property in order to increase its energy efficiency and which are eligible for inclusion in the Green Deal. In order to be eligible for inclusion in the Green Deal the measure must: • Be recommended for that property by an Accredited Adviser; and • Meet the criteria set out in secondary legislation to be eligible for inclusion in the Green Deal; and • Be included in the list of products and measures in the published Green Deal Code of Practice.
Green Deal Customer	The Green Deal Customer is the property owner or tenant who contracts with the Green Deal Provider for assessment, installation and financing of the Green Deal for the building which they own or occupy. Green Deal Customers

are expected to include (but may not be exclusive to):

- Individual tenants, owner-occupiers or landlords
- Business tenants, owner-occupiers or landlords; and
- Public sector tenants, owner-occupiers or landlords.

Energy Supplier	The Energy Supplier is expected to be the customer's electricity energy supplier.
The Golden Rule	The Golden Rule is a key principle of the Green Deal whereby the expected overall cost to the consumer cannot exceed the total expected savings. Meeting the Golden Rule is a pre-requisite for acceptance of a customer into the Green Deal.

Public Sector Accounting

Administration Budget	The part of a Department's budget that is allocated to cover the costs of administrative activities, such as the costs of operating the finance function. Administration budgets can be used to fund programme activities, but programme budgets can only be spent on administrative activities with the approval of HM Treasury.
AME	Annually Managed Expenditure - Expenditure which is volatile and large, or that is not easily controlled, is significant and demand led. For example, social security payments are classified as AME spending. AME takes the first cut of the overall public spending envelope. AME forecasts are updated twice a year with HM Treasury holding the risk of variance in outturn compared to plan.
CBG	Consolidated Budgeting Guidance - The Resource Budgeting rules are defined by the Consolidated Budgeting Guidance
CDEL	Capital Departmental Expenditure Limits - The part of a department's DEL budget allocated to cover capital spending and net lending transactions. Includes spending on buildings, ships, roads, hospital equipment and any other capital expenditure, howsoever financed, as well as net lending. CDEL aims to constrain the impact of public sector activity on PSNI, PSNB and PSND, as measured by the National Accounts. Whilst RDEL can be spent on capital items, CDEL cannot be spent on resource items without the permission of the Chief Secretary to the Treasury.
CLOS	Clear Line of Sight – A project designed to better align the Estimates, Resource Budgeting and Resource Accounts with National Accounts. CLOS related changes have been partially implemented in 2010/11, with full implementation due in 2011/12.
CSR	Comprehensive Spending Review - A triennial review of public sector spending in which departmental spending limits are set for the forthcoming three financial years.
DEL	Departmental Expenditure Limit – In aggregate, DEL is the expenditure available to allocate to departments after the AME forecast has taken the first cut of the spending envelope. DEL is allocated to departments through the Spending Review process. Departments have separate RDEL and CDEL limits. RDEL cover may be switched to CDEL, but CDEL cover cannot be switched to fund RDEL pressures without permission of the CST.
ESA95	European System of Accounts 1995 - A European Union wide set of national accounting standards, which EU member states are legally obliged to adhere to under the Maastricht Treaty. The ONS uses these standards to compile the National Accounts and Public Sector Finance Statistics. (see also SNA and MGDD)

Estimates	The process by which Parliament has the opportunity to vote on the Government's spending plans. There are differences between Estimates and budgets (e.g. Expenditure is shown net of receipts in budgets and gross in Estimates), but the Clear Line of Sight (CLOS) project aims to better align the two systems.
FRS	Financial Reporting Standard - FRSs form the majority of the UK GAAP accounting standards. For example FRS 15 deals with Fixed Asset accounting. SSAPs and UITFs are also standards included within the UK GAAP accounting standards.
GDP	Gross Domestic Product - A measure of the value of economic output across the economy (includes the output of both the public and private sectors).
IAS	International Accounting Standards - IASs form the majority of the IFRS accounting standards. For example IAS 16 deals with Fixed Asset accounting. IASs are the IFRS equivalent of the UK GAAP FRSs. IFRICs and SICs are also standards included within the IFRS accounting standards.
IFRIC	International Financial Reporting Interpretations Committee – The IFRIC has issued a set of interpretations which form part the application of IFRS accounting. These pronouncements generally interpret the IASs for specific types of transactions/industries. For example, IFRIC 12 ‘Service Concession Arrangements’ is an interpretation that deals with the accounting for PFI contracts by the private sector operator of such contracts.
IFRS	International Financial Reporting Standards - Set of accounting rules adopted across Europe. FTSE 100 companies are required by law to present accounts prepared under these standards. Central Government adopted IFRS from 1 April 2009, with Local Government adopting them from 1 April 2010.
MGDD	Manual on Government Deficit and Debt - A manual, issued by the EU statistical authority Eurostat, that supports and clarifies the ESA 95 National Accounts standards – especially relevant for PFI. (see also SNA and ESA 95)
ONS	Office for National Statistics - Independent non-ministerial government department responsible for compiling the National Accounts statistics (including GDP, PSNI, PSNB and PSND) in accordance with ESA 95 standards.
PFI	Private Finance Initiative - Schemes whereby the private sector finances, constructs and operates assets, including the subsequently provision of services associated with that asset over a number of years.
PPP	Public Private Partnership – often used as an umbrella term to describe a range of models under which the public and private sector contract. Commonly used to describe entities that are a collaboration between public and private bodies as well as PFI transactions.
Programme budget	The part of a Department's budget that is allocated to front line activities, such as the day to day costs of delivering policy objectives.
PSGI	Public Sector Gross Investment - A measure drawn from National Accounts of the investment in new public sector infrastructure, ignores the impact of depreciation on the existing stock of assets.
PSNB	Public Sector Net Borrowing - A measure drawn from the National Accounts of the amount the public sector needs to borrow each financial year to finance its capital and

current spending. PSNB is defined as current receipts minus the sum of public sector current and capital expenditure.

PSND	Public Sector Net Debt - A measure of the stock of public sector debt. PSND is measured as the sum of certain financial liabilities of the public sector less the value of cash and cash equivalents at a given point in time. At the end of May 2010, PSND was £903bn
PSNI	Public Sector Net Investment - A measure drawn from the National Accounts of investment in public sector infrastructure, net of the depreciation charged against new and existing infrastructure.
RAB	Resource Accounts and Budgeting - Resource accounts are financial accounts prepared in accordance with the accounting standards. Resource budgets are prepared in accordance with the consolidated budgeting guidance, which broadly aligns with the accounting standards. Together they form a system used to score/classify, control and constrain public sector spending.
RDEL	Resource Departmental Expenditure Limits - The part of a department's budget allocated to current spending, which includes salary costs, rent, utilities, consumables etc. Together, RDEL and CDEL make up a department's controlled expenditure limits for which departmental management are held accountable for adhering to.
SNA	System of National Accounts (1993) – System of national accounts to allow comparison of national economic statistics across UN member countries. (See also ESA95 and MGDD)
TME	Total Managed Expenditure – Total public sector spending, being the sum of public sector current and capital expenditure. CDEL, RDEL and AME sum to TME.
UK GAAP	United Kingdom Generally Accepted Accounting Principles - Set of accounting rules adopted in the UK. Central Government applied UK GAAP accounting standards up until 31 March 2009, but moved to IFRS as of 1 April 2009. Local government applied UK GAAP up to and including the 2009/10 financial year, but have moved to IFRS as of 1 April 2010.

Appendix 2 – DECC’s representation of the financing structure

Figure C1: Green Deal financing model

