Reference 20082008. NL Waste Authority.M O'Donnell

20 October 2008

Mike O'Donnell
Director of Finance
North London Waste Authority
Camden Town Hall
Judd Street
London
WC1H 9JE

Direct Line 0844 798 2304
Email p-johnstone@audit-commission.gov.uk

Dear Mike,

North London Waste Authority waste disposal PFI scheme, initial view of accounting treatment

Thank you for your request for our view of accounting treatment on the proposed waste PFI scheme. I set out below my views and the context within which they are provided to you.

Responsibilities of the audited body and auditor

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

The Audit Commission's *Code of Audit Practice for Local Government* (the *Code*), prescribes how auditors should carry out their statutory functions. It is not part of the external auditor's role to provide accounting advice to you or to act as an accounting adviser. The *Code* requires that the auditor acts independently at all times.

The purpose of this letter is to provide the Authority with a view of the proposed treatment of the scheme from the perspective of the external auditor within the above context.

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. The views set out in the letter are based upon the information presented to me as at 17 October 2008 in the document listed in the Annex. If these facts change as the scheme progresses or contract negotiations are completed or if further relevant information becomes available then 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 Authority's financial statements. It will be for the Authority's auditors at that time to give the final judgement on the scheme's accounting treatment.

International Financial Reporting Standards (IFRS)

The Authority has appointed Ernst and Young as its advisors and they have noted that as this project is expected to reach operational status in 2014/15 they have used the HM Treasury Guidance on Accounting for PPP Arrangements, including PFI Contracts, under IFRS (the HMT Guidance) to review the accounting treatment for this project.

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

In your capacity as Director of Finance, you have confirmed to me that your initial judgement on the proposed accounting treatment, is that the transaction should be accounted for as 'on' the Authority's balance sheet.

The Authority financial advisors have provided you with advice on whether this transaction should be accounted for as on or off the Authority's balance sheet. I have briefly summarised their approach to this analysis below.

Approach to accounting opinion

Your advisors have concluded that the assets to be provided under this PFI contract fall within the scope of IFRIC 12. Where assets fall within the scope of IFRIC 12, HM Treasury Guidance requires the public sector to record the infrastructure assets on its balance sheet and also a corresponding financial liability. In undertaking their analysis, your advisors have undertaken a two stage review.

Firstly they have concluded that the assets to be provided by the PFI scheme would be infrastructure assets within the definition provided section 6.2.28 of HM Treasury's IFRS based Financial Reporting Manual (iFREM), which is applicable to the public sector from 2009/10 on.

Secondly, your advisors assessed if the arrangements met the two conditions which define an arrangement as being within the scope of IFRIC 12. The two conditions examine which party controls or regulates the services to be provided and which party controls any significant residual interest in the infrastructure at termination or expiry of the arrangement. Your advisors conclude that the Authority controls both the services to be provided and the significant residual interest in the infrastructure at the expiry of the arrangement, i.e. that the two conditions are met.

Your advisors note that the assets should therefore be recorded on the Authority's balance sheet with a corresponding liability. They go on to note the main principles which you should adopt in relation to the ongoing accounting for the asset and liability and payments in respect of the services delivered using the assets created.

Comments on audit view

In my view, on the basis of the information provided to me to date and listed in the annex to this letter, I would not be minded to challenge at this time the view that the contract is likely to result in the creation of assets which the Authority should recognise within its financial statements.

Yours sincerely

[redacted]

Philip Johnstone
District Auditor

cc [redacted], NLWA Finance Officer
[redacted], NLWA Finance Officer
[redacted], Audit Manager