EUROPEAN COMMISSION
EUROSTAT

Directorate D: Government Finance Statistics (GFS) and quality
**Unit D-3: Excessive deficit procedure (EDP) 2**

Luxembourg, 14 June 2018

# FINAL FINDINGS

## EDP dialogue visit to the United Kingdom

### 16 - 17 May 2017

## Executive summary

Eurostat undertook a standard EDP dialogue visit to the United Kingdom on 16-17 May 2017. The purpose of the visit was to review the quality framework, audit and internal control arrangements in place, to review data sources for the EDP data compilation as well as to review methodological issues and the sector classification of units and PPP arrangements in place.

Eurostat welcomed the independent nature of the classification work done by the Economic Statistics Classification Committee. The quality management framework currently in place was reviewed in detail. There is a fully aligned UK version of the ESS Code of Practice and in addition the ONS has its own Quality Management Strategy, with a specific version for National Accounts on top of that. Moreover, data sources were discussed focussing in particular on the Central government database (OSCAR), and on the quality assessment of accrued income tax recording.

The progress made by the UK authorities on the open action points from the EDP visit of April 2015 were also discussed and a few remaining issues from the April 2017 EDP notification were clarified and will be subject to further analysis to be provided by the ONS and official replies to be provided by Eurostat. The application of the ESA 2010 methodological rules was also discussed. The sector classification of several units, like the Financial Services Compensation Scheme, the Hinkley Point nuclear power plant, the school renovation schemes under the PF2 model, the Scottish and the Welsh PPP model and the 'Enable Scheme' of the British Business Bank were discussed in detail. Eurostat emphasized the importance of properly examining signed project contracts in detail and to evaluate them as a whole.

Eurostat appreciated the information provided by the UK authorities before and during the EDP standard dialogue visit. Eurostat also thanked the UK authorities for their co-operation during the mission, and considers that the discussions were productive and constructive.

# Final findings

## Introduction

In accordance with Council Regulation (EC) No 479/2009 of 25 May 2009, as amended, on the application of the Protocol on the excessive deficit procedure annexed to the Treaty establishing the European Community, Eurostat carried out an EDP dialogue visit to the United Kingdom on 16-17 May 2017.

The delegation of Eurostat was headed by Mr Eduardo Barredo Capelot, Director of Directorate D: Government Finance Statistics (GFS) and quality. Eurostat was also represented by Mr Philippe de Rougemont, Ms Laura Wahrig, Ms Anabela Nabais Rodrigues and Mr Alexander Reimers. A representative of the Directorate General for Economic and Financial Affairs (DG ECFIN) also participated in the meeting as observer.

The United Kingdom was represented by the Office for National Statistics (ONS), Her Majesty's Treasury (HM Treasury), the Bank of England (BoE), the Office for Budget Responsibility (OBR), Her Majesty Revenue & Customs (HMRC) and the Department of Communities and Local Government (DCLG).

The previous Eurostat EDP dialogue visit to United Kingdom took place on 28 – 29 April 2015.

Eurostat carried out this EDP dialogue visit in order to discuss the quality framework and the audit and internal control arrangements in place, to review data sources for the EDP data compilation, methodological issues and the sector classification of units as well as PPP arrangements in place.

With regard to procedural arrangements, the *Main conclusions and action points* have been sent to United Kingdom for review and subsequently agreed. Then the *Provisional findings* were sent to the United Kingdom for review. After this, *Final Findings* will be sent to the United Kingdom and the Economic and Financial Committee (EFC) and published on the website of Eurostat.

Since the Eurostat EDP dialogue visit to the United Kingdom, several action points have been discussed and the ONS has provided additional documents.

Eurostat appreciated the fact that the UK authorities contributed to the smooth organisation of the visit with their open and constructive approach during the meeting as well as with documents provided before the visit.

# 1. STATISTICAL CAPACITY

## 1.1. Institutional responsibilities and EDP process

*Introduction*

Eurostat enquired about the current division of work for the EDP data compilation between ONS and HM Treasury and asked if there have been any changes. The classification work done by the Economic Statistics Classification Committee (ESCC) was also discussed.

*Discussion and methodological analysis*

The Office for National Statistics (ONS) and HM Treasury (HMT) are jointly responsible for the measurement of government deficit and debt, as published, for instance, in the monthly Public Sector Finances (PSF) bulletin. The ONS calculates historical data for past years and HM Treasury provides forecasts for future years. The classification of bodies to the General Government sector is the sole responsibility of the ONS (notably, the Economic Statistics Classification Committee).

The UK authorities confirmed that there had not been any substantial changes to the UK institutional arrangements regarding the compilation and publication of EDP data since the last Eurostat dialogue visit to the UK in 2015. However, there have been some changes in staff since the last dialogue visit.

The EDP statistics are compiled by the ONS within the Public Sector division, which is in the National Accounts and Economic Statistics directorate. The Public Sector Division contains a number of different teams (or branches). The Public Sector Finances (PSF) and EDP delivery branch is the team responsible for compiling the EDP data (and GFS ESA Tables 2, 9, 25, 27 & 28), transmitting it to Eurostat and publishing it in UK statistical publications. To do this, the branch has its own EDP compilation processes and systems but it is reliant both on the data and work of other ONS branches and on administrative data provided by government bodies. For a better understanding, the ONS provided Eurostat with an updated organisational chart.

The central and local government delivery branches compile the general government (and sub-sector) financial and non-financial accounts for the UK National Accounts. To do this, it draws on data supplied by HMT through its Online System for Central Accounting and Reporting (OSCAR) database, the Department for Communities and Local Government (DCLG), HM Revenue & Customs (HMRC), other government departments, devolved administrations and other National Accounts teams within the ONS. The above mentioned branches also produce ESA Table 11.

The ONS has cooperation agreements with their data suppliers of which the main are: HM Treasury, HM Revenue & Customs, Department for Communities and Local Government (DCLG) and the Bank of England.

The data processing has been improved through quality processes and currently the production system is under review. In the next coming three years, a renovated production system should be started.

*Findings and conclusions*

*Main findings*: Eurostat takes note of the complete independence of ONS, deciding on the classification of units (via the Economic Statistics Classification Committee) and on the treatment of transactions, and considers this as an example of good practice.

***Action Point 1***: The ONS will explore the possibility to publish the Service Level Agreements between the ONS and the main suppliers of statistical data and to communicate their view on this procedure to Eurostat[1].

*Deadline: September 2017*

### 1.2. Quality management framework

*Introduction*

The discussion focused on quality mechanisms in place and how they are applied in the UK.

*Discussion and methodological analysis*

The UK Statistics Authority (UKSA) has a wide range of policies and activities governing the production of quality data. There is a fully aligned UK specific version of the ESS Code of Practice setting out the framework under which UK National Accounts are produced and published in the UK Statistics Authority Code of Practice for Official Statistics:

http://www.statisticsauthority.gov.uk/assessment/code-of-practice/index.html

The code applies not only to the ONS statistics but to all official statistics produced by the Government Statistical Service (GSS) network. The UKSA is empowered to enforce the code under the Statistics and Registration Service Act 2007. To ensure compliance with these practices/policies, the UKSA carries out periodic assessments of each statistical output.

Additionally the ONS has its own Quality Management Strategy. National Accounts has its own Quality Management Strategy based on the ONS version. Statistics on Public Sector Finances was at the time undergoing a UKSA assessment, and the ONS PSF/EDP team was expecting to receive confirmation of the designation of the statistics as National Statistics following the work done to address the recommendations of the October 2015 assessment (the previous similar kind of assessment was done in 2011). The work done to document the quality assurance procedures around administrative data was highlighted by the UK Statistical Authority as exemplary and ONS had been able to make improvements to the quality assurance process as a result of compiling this documentation[2].

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[1] The ONS has entered into discussions with the suppliers of relevant statistical data on this topic.

[2] See: https://www.statisticsauthority.gov.uk/publication/15302/

In addition to Service Level Agreements (SLAs) with external data providers, there are Internal Delivery Agreements with National Accounts data providers. EDP supplier meetings are arranged prior to the quarterly rounds and these meetings are used as an opportunity to discuss any issues arising with data providers. In these internal meetings, possible problems related to data, like source data delays, are discussed and these internal discussions feed backwards as well. For example, if there is a problem with source data, it is communicated to the source data providers in order to have them corrected/reviewed. These monthly meetings are used to review with HM Treasury, the Office for Budgetary Responsibility and data suppliers the revenue data eight working days after the end of the month. The results are published within the monthly Public sector finances15 working days after the end of the month.

The revision policy follows a codified process. Revisions analysis is conducted via excel spreadsheets on all source data series delivered by data suppliers. Any significant revisions, discrepancies and growth rates are immediately investigated with the data supplier. In addition, data suppliers provide briefings each quarter to explain the revisions. The briefings clearly illustrate the movement in the source data series and explain why the series have been revised.

Revisions analysis is repeated on the output tables to ensure that all revisions can be explained and are consistent across GFS and EDP tables. Revisions analysis workbooks have been created in excel in order to illustrate the differences between the current EDP tables and the previous submission. This is to ensure that the data are internally consistent and revisions can be explained. However, some differences exist between the revision policies of National Accounts and EDP/GFS. This issue will be partially addressed through the implementation of a new system. The existence of some inconsistencies between non-financial and financial accounts is due to different data sources and some missing information mainly in accounts receivable/payable.

Eurostat took note of the quality framework put in place by the UK authorities and appreciates the open revision policy for EDP and GFS.

*Findings and conclusions*

***Action point 2***: The ONS will aim to ensure consistency of annual (calendar year) data reported in GFS and other ESA tables at least once per year.

*Deadline: Continuous*

## 1.3. Audit and internal control arrangements

*Introduction*

The discussion focused on current audit arrangements.

*Discussion and methodological analysis*

The National Audit Office carries out external audits of central government entities. Departmental accounts are available within three months and the Whole government accounts after one year.

The Audit Commission, until its closure in 2015, appointed auditors for local government bodies. Under the new arrangements, English local government bodies are able to appoint auditors themselves although legislation provides safeguards to ensure auditor independence and high audit standards. The devolved administrations have put in place their own audit arrangement overseen by specialised audit institutions under public sector control.

Local government accounts, like those of all UK government bodies, are based on IFRS standards. The Financial Reporting advisory board (FRAB) oversees the development of the financial reporting requirements, while the Chartered Institute of Public Finance Accountancy (CIPFA) helps ensure that the reporting requirements are applied appropriately and consistently.

The UK authorities raised the issue of the new IFRS rules for the recording of leasing transaction from 2019 onwards. These amendments of the current recording rules will lead to consistency issue between commercial accounting and statistical accounts, recorded under ESA 2010, which will need addressing.

This topic has been discussed in the July 2017 EDPS Working Group (see item 5.7.3) and will be followed-up with the Eurostat EPSAS Task Force.

*Findings and conclusions*

Eurostat took note of the current general government audit procedures and internal control practices.

***Action point 3**:* The ONS will inform Eurostat about the latest position of the audit framework for local government[3].

*Deadline: September 2017*

[3] The ONS has provided to Eurostat detailed information about the organisation of the audit procedures for local governments. Eurostat considers this action point as closed.

### 1.4. EDP Inventory

*Introduction*

The discussion focused on the progress made in reviewing an updated ESA 2010 version of the EDP inventory for the UK.

*Discussion and methodological analysis*

The last EDP inventory based on ESA 2010 was published in 2016, following the last EDP dialogue visit. Eurostat emphasised the amended methodology on corporate tax recording and encouraged the ONS to update the current EDP inventory. The ONS works currently on an update of the EDP inventory. During the discussion, the ONS committed to provide a full draft of the new EDP inventory during the summer, which would allow Eurostat to make possible comments, and the final version of the inventory would be provided to Eurostat by September in order to be published on Eurostat website before the October 2017 notification.

*Findings and conclusions*

***Action point 4****:* The ONS will revise and subsequently submit to Eurostat the revised EDP inventory for publication.

*Deadline: September 2017 for publication*[4]

## 2. REVIEW OF KEY DATA SOURCES

### 2.1. Central government database (OSCAR) and Whole of Government Accounts

*Introduction*

The discussion focused on the OSCAR database and the Whole of Government Accounts, and how they are used as source data.

*Discussion and methodological analysis*

The ONS explained that OSCAR (Online System for Central Accounting and Reporting) is the HM Treasury database that collects financial information from central government departments and the devolved administrations, for the purposes of parliamentary and statistical reporting and spending control. Therefore, OSCAR is not to be considered as a general ledger, but as a consolidation tool for government expenses and revenues. It serves for parliamentary accountability. OSCAR records expenditure and revenue data on an accrual basis, while the data from HM Treasury is on a cash basis. The ONS explained that there is a long term plan to improve the connectivity between OSCAR and ONS systems. This technical innovation is part of the mid-term plan.

[4] Eurostat agreed on ONS' request to postpone the publication of the updated EDP inventory allowing to completing a full review. The review is still ongoing.

Expenditure data and departmental revenue data (i.e. excluding tax revenue and interest receivable data) for the Central Government sub-sector are provided by OSCAR. The data are consolidated by the department or by the devolved administration and provided to the ONS as the definitive estimate of central government spending. The ONS receives a fully detailed data extract from OSCAR that includes transactional data at department/entity level. Central government departmental (and devolved administration) expenditure data (provided via OSCAR) are subject to various validation processes and improve over time.

HM Treasury publishes OSCAR data as supplied by departments every quarter.

OSCAR data codes are paired with ESA transactions and COFOG codes within its coding framework and, so, relatively few adjustments are required when reporting the data for the purpose of Government Finance Statistics. However, adjustments may be made to the OSCAR data reported by various departments and devolved administrations as a result of quality assurance following contact with departments.

The OSCAR system gives flow information on an accrual basis and without any cash reporting. However it delivers the net cash requirement on a departmental / unit level for parliamentary scrutiny. There is no meaningful balance sheet produced, but a net expenditure position.

Eurostat inquired about the handling of errors. The ONS explained that adjustments to correct data can be made as a result of the monthly quality assessment for each department. These corrections are then applied and published in GFS data. On several topics, the ONS do not use OSCAR as data source. As an example, the ONS uses data for capital consumption based on ONS models rather than OSCAR data and do not use OSCAR data on provisions (which are out of the ESA scope).

In addition, Eurostat underlined the importance of availability of AF.2 assets and AF.8 receivables/payables for GFS data.

*Findings and conclusions*

***Action point 5***: The ONS will examine the possibility to extract the AF.2 assets and AF.8 receivables/payables positions of general government from the whole of government accounts (WGA).

*Deadline: December 2017*[5]

## 2.2. Data sources for deposits and recording of cheques

*Introduction*

In compiling government cash and deposit asset data (S.13 AF.22A and AF.29A) for the UK National Accounts and Excessive Deficit Procedure (EDP) transmission ONS largely use data sourced from Bank of England (BoE) surveys of financial corporations (i.e. counterpart data) rather than government administrative data.

[5] Action point under evaluation

The two principal reasons for this are that:

- The Bank of England survey data are collected monthly (or in the case of some surveys, quarterly) and so provide timely in-year data for compiling public sector finances, EDP returns and National Accounts;
- The Bank of England survey data cover the whole UK Economy and so provide a single consistent data source for compiling sector estimates for the National Accounts that are consistent.

These sources are completed by data from:

- data from the Bank of England on Official Reserve assets
- data from the Debt Management Office on deposits and repos within the debt management account
- data from Network Rail on their cash and deposit holdings
- data from UK Asset Resolution Ltd on their cash and deposit holdings
- other data from HM Treasury on their cash and deposit holdings.

*Discussion and methodological analysis*

The ONS explained that the core set of central government bank accounts are held at the Bank of England (BoE) with the management of these allowing the Government to minimise idle cash balances, using any surplus cash to reduce outstanding Government net debt – thus avoiding unnecessary interest payments by the government or increasing its interest income. The BoE data used in GFS/EDP includes not only these core central government bank accounts but also deposits held by government bodies within commercial banks.

Concerning the question of the recording of cheques, the ONS as well as the BoE do not have detailed information available. This issue is also discussed in the methodological task force.

*Findings and conclusions*

***Action point 6:*** The UK statistical authorities will provide to Eurostat the reconciliation table between Debt Management Accounts (DMA) data and the Treasury's cash management data.

*Deadline: September 2017*[6]

***Action point 7:*** The UK Statistical authorities will provide Eurostat with the materiality of usage of cheques (both as receivables and payables) in central government accounts, and their statistical recording.

*Deadline: September 2017*[7]

[6] Action point under evaluation

[7] The ONS has provided to Eurostat an analysis of the current recording of cheques in government accounts and the materiality of such transactions.

## 2.3. Regional accounts

The ONS presented briefly the publication of regional accounts due to the increasing importance of the devolved administration (Scotland, Wales and Northern Ireland); the latter having introduced new challenges to existing data sources. In February 2016, ONS launched a consultation in order to gather and assess the user demands for ONS producing an annual publication on country and regional public sector finance statistics. Responses to the consultation indicated that there was wide support for country and regional public sector finance statistics, with potential use in order to aid the devolution debate and to provide additional data for local policy analysis.

These data allocate total UK public sector revenues to the region where the individual or institutional units, which pay to government, are resident. Expenditure is allocated to the region where individual or institutional units, which benefit from this expenditure, are resident.

*Findings and conclusions*

Eurostat took note of this new approach.

## 2.4. Local government data

The Data for the local government sub-sector are collected from statistical returns or administrative sources. ONS does not collect the data directly. Instead, the data are mainly collected by the Department for Communities and Local Government (DCLG), or by the devolved administrations in Scotland, Wales, and Northern Ireland.

In addition, data for some financial accounts series are provided by other sources. For example local government banking deposits series are provided by the Bank of England. Data for some non-financial accounts series are provided by other teams within ONS. For example capital consumption estimates are calculated by the capital stocks team using the perpetual inventory method.

The local government sub-sector is heavily dominated by spending by Local Authorities in the UK. These include, for example county councils, city councils, and London borough councils. Total data coverage is achieved for these bodies on an annual basis, through 100% response rates. For some of the quarterly and monthly data collections, it is occasionally necessary for the surveying body to estimate for missing returns. Other bodies in the local government sub-sector with notable spending include police and fire authorities, which are also included in statistical data collections, and in recent years Transport for London, including Crossrail, a large infrastructure project in London. In particular, the ONS is carefully separating the data relating to the public corporations and the local government sub-sectors.

The data collections carried out by the Department for Communities and Local Government and the devolved administrations are carried out using these same reporting standards wherever possible. The data are provided for a mixture of periodicities, sometimes for months, sometimes for quarters, and sometimes for a financial year (April to March). ONS is working with data suppliers to obtain at least quarterly data wherever possible. When quarterly data are not available, the financial year amounts are divided by four. In order to ensure compliance with ESA 2010, some adjustments are made to the data provided by the Department for Communities and Local Government (DCLG) and by the devolved administrations.

*Discussion and methodological analysis*

Eurostat wanted to learn about the time of recording of transactions between central and local government units.

The ONS explained that central government data is available on a monthly basis, but local government data is generally less timely and in addition data are considered less accurate. This can lead to the creation or the reduction of discrepancies.

Concerning expenditure data, only England delivers quarterly data. Therefore, the England pattern of capital expenditures is applied to the data coming from Scotland, Wales and Northern Ireland and revised when final data is available.

These anomalies are barely due to time lags of data, however to other problems. Nevertheless, it can occur that negative expenditures after consolidation are recorded in particular arising from investment grants refunds. In addition, the final data recording follows the fiscal year from April to March. Any discrepancies will lead to investigations.

Eurostat underlined that negative entries due to consolidation between central and local government data should be investigated, analysed and eliminated as far as possible.

*Findings and conclusions*

***Action point 8***: The ONS will provide Eurostat with an analysis of the observed differences between OSCAR and local government accounts concerning intra-government transfers.

*Deadline: September 2017*[8]

***Action point 9***: The ONS will further monitor the source data with the objective of eliminating negative entries in revenue/expenditure (in particular arising from investment grants refunds) that lead to some negative consolidation amounts currently reported in ESA tables.

*Deadline: December 2017*[9]

[8] Action point under evaluation

[9] In the December 2017 GFS delivery, the ONS has eliminated negative entries in quarterly and annual aggregate data. Eurostat considers this action point as closed.

## 3. FOLLOW UP OF THE APRIL 2015 EDP DIALOGUE VISIT

*Introduction*

Eurostat and the UK authorities discussed the follow up points from the last EDP dialogue visit relating to the statistical classification of specific operations and the recording of PPPs/concession contracts.

*Discussion and methodological analysis*

Out of 18 actions points agreed during the previous visit in April 2015, 14 have been completed. Two outstanding actions points were discussed under the following agenda points:

- 5.5 Classification of the "Enable Scheme" set up by the British Business Bank (former action point 18)
- 5.9 Classification of the Hinckley Point Nuclear Power Plant (former action point 17).

The remaining two actions were discussed under this agenda point. During the 2015 EDP dialogue visit, the following action was agreed:

*Action point 13. "Eurostat and the ONS will examine the PF2 model of contracts (last version) with the view to determine whether the PPP contracts following this model will be classified on or off government balance sheet."*

The UK authorities have since provided initial information. The ONS explained, that following the introduction of ESA 2010 and the relating MGDD 2016, the UK authorities have decided to review the PF2 model. The Economic Statistics Classification Committee (ESCC) is currently assessing the classification issue related to this PPP model framework.

*Findings and conclusions*

***Action point 10**:* The UK Statistical authorities will provide Eurostat with their statistical analysis of the updated PF2 model.

*Deadline: July 2017*[10]

The following action was also agreed during 2015 EDP visit:

*Action point 15. "The ONS and Eurostat will examine the three existing PPP contracts, recently signed, concerning school renovation under the PF2 model."*

The UK authorities have provided since the last EDP dialogue visit initial and supplementary information. Considering the ownership structure, the existing control elements and the financial arrangements, the ONS and Eurostat agree, that these PF2 model assets have to be classified on government balance sheet.

[10] Initial information has been provided by the ONS and is currently analysed by Eurostat.

*Findings and conclusions*

***Action point 11***: Eurostat agrees in principle on the classification into the general government sector of the PF2/school model projects, as suggested by ONS. Eurostat will provide to the ONS an official reply on this point.

*Deadline: July 2017*[11]

Finally, concerning the classification of the Financial Service Compensation Scheme (FSCS), the ONS and Eurostat agree, that the FSCS has to be classified in the general government sector. Eurostat provided an advice letter on this classification issue in April 2017. The ONS asked if an updated advice letter could be produced by Eurostat, which includes references to the most recent discussion of the EDPS Working Group and the forthcoming Eurostat guidance note.

*Findings and conclusions*

***Action point 12****:* Eurostat will provide an 'advice' (official letter) on the sector classification of FSCS in the light of the forthcoming new guidance note to be published by Eurostat on the statistical sector classification of protection funds.

*Deadline: July 2017*[12]

# 4. FOLLOW-UP OF THE APRIL 2017 EDP REPORTING – ANALYSIS OF EDP TABLES

*Introduction*

Eurostat and the ONS discussed a few open items following the April 2017 notification.

*Discussion and methodological analysis*

<u>EDP Table 1 and EDP Questionnaire table 5</u>

During the April 2017 EDP notification, the UK authorities have introduced the accrual principle to the recording of corporate taxes. This led to significant revisions in the deficit recording from year 2000 to year 2015. In addition, this methodological change led to very significant upward revision in accounts receivable of D.5 taxes.
This issue will be discussed under item 5.2.

<u>EDP Table 3 and EDP Questionnaire table 5</u>

During the EDP notification of October 2016 and April 2017, Eurostat and the ONS have discussed the recording of claims (AF.89 receivables) against the financial sector due to government intervention to support financial institutions in the financial crisis. The recording of this support in EDP table 3A as loan as receivable from the financial institution sector shall be clarified.
This issue will be discussed under item 5.5.1

[11] Action point under discussion
[12] Action point under discussion

EDP Questionnaire table 10

During the April 2017 EDP notification, the issue of dividend payments by the Bank of England to the central government was raised. These dividends could be paid out of the net result realised by the Asset Purchase Facility (APF), a subsidiary set up by the Bank of England to manage the quantitative easing policy after the financial crisis. The Assets held by the APF are limited to bonds issued by government. The APF is held harmless against any loss by guarantee of HM Treasury.
This issue will be discussed under item 5.5.2

# 5. METHODOLOGICAL ISSUES AND RECORDING OF SPECIFIC GOVERNMENT TRANSACTIONS

## 5.1. Delimitation of the general government sector

### 5.1.1. Review of the classification of universities

*Introduction*

Eurostat and the ONS discussed the classification of universities in the light of economically relevant prices charged to students, the market/non-market aspect and the issue of control.

*Discussion and methodological analysis*

Together with the Republic of Ireland, the UK presented a unique case in the European context. Thus, the classification of universities had been discussed in a number of EDP dialogue visits and was subsequently brought to the Financial Accounts Working Group in 2008. Eurostat reviewed the UK approach and concluded that it was in line with ESA 95 and the accompanying Manual for Government Debt and Deficit.

Over the last years, a triple rise of tuition fees for domestic undergraduate students took place. Additionally, the introduction of the European System of Accounts 2010 (ESA 2010) and the work on the new Higher Education and Research Bills in the constituent countries of the UK prompted ONS to revisit the classification. In 2016, a classification review of universities in the United Kingdom was announced. This review concerns almost 160 universities and university colleges.

Government control

Most (although not all) UK universities are registered charities, and therefore non-profit institutions (NPIs). Irrespective of the legal status, the framework for the functioning of the university governing bodies is enshrined in the Acts of Parliament. In their day to day work, universities are almost independent and this independence is reinforced by ongoing legal changes, although the procedure for senior board members' nomination is codified in the legislation. The academic independence is also protected by law. The charity law under which universities act protects these from government influence. Eurostat is not fully convinced of the absence of any element that would point to control of government on universities.

The government funding of almost all universities has reduced over the time, while tuition fees have risen. Nevertheless, some exception still exists in particular in Northern Ireland and Scotland. This might lead to a control on specific universities.

Market test

UK universities have two main resources: tuition fees and other income from research activities. Tuition fees can be considered as sales, while research resources can come from subsidies as well as from the private sector. ONS is reviewing the types of research funding to establish implications on the market test as part of the assessment.

Eurostat inquired if tuition fees for undergraduate UK and EU students can be considered as economically significant prices and to what extend universities are free to set their tuition fees although respecting the cap established by law. It was further discussed if subsidies granted to universities have to be considered as subsidies on products or on production. In addition, the ONS explained the selection of undergraduate students. In this context, Eurostat invites the UK statistical authorities to comment on the document presented in the Task Force on methodological issues on 10-11 May 2017 on the subject (item 9).

*Findings and conclusions*

***Action point 13****:* The UK Statistical authorities will reflect on the market/non market character of universities, particularly whether fees paid by residents meet the economic significant price criteria and whether funding is available to all universities on a similar basis. This entails notably deciding whether the grants of government to universities have the character of a subsidy on products, or not. In this context, the UK Statistical authorities are invited to comment on the document presented in the Task Force on methodological issues on 10-11 May 2017 on the subject (item 9). They will also send to Eurostat their classification analysis for two universities located outside of London, one belonging to the Russell group and one outside of this group.

*Deadline: December 2017*[13]

### 5.1.2. Government bodies included in table 2A

Introduction and discussion

Eurostat and the ONS discussed the units which are consolidated in the Central Government Net Cash Requirement (CGNCR). The ONS explained that the bulk of the CGNCR was sourced from Treasury cash management systems but that there were some additional bodies which were covered in this balance and are added by the ONS. The ONS further explained that the CGNCR data were not subject to the approval of parliament but were key fiscal aggregates reported in the national monthly public sector finance release.

Eurostat enquired whether the Central government and Local government net cash requirement can be used as a working balance controlled by the parliament and therefore this aggregate could be used as a working balance in EDP table 2.

[13] This action point is under discussion.

*Findings and conclusions*

***Action point 14****:* The UK Statistical authorities will provide Eurostat with new EDP tables 2 using the 'net cash requirement' as working balance, for the October 2017 notification[14].

*Deadline: End of September 2017.*

5.1.3. Delimitation between government and Bank of England – issuance of bank notes

*Introduction*

In the UK the Bank of England, three Scottish and four Northern Irish banks are authorised to issue banknotes. The recording and the rerouting of these banknotes was discussed between Eurostat and the ONS.

*Discussion*

The Bank of England is the body authorised to issue UK banknotes and it has been performing this function for over 300 years. The Bank of England is required to hold high quality assets equal in value to the total value of all banknotes in circulation.

In addition, three Scottish and four Northern Irish banks are authorised to issue banknotes, but in counterpart they have to hold, likewise the Bank of England, quality assets, of which 60% must be banknotes issued by the Bank of England.

The Bank of England makes profits out of the interest payments received on assets held in counterpart of the issued banknotes. In 2016, the Bank of England paid £ 462 m of dividends related to the issuance of banknotes. These dividend payments are subject to the super-dividend test and recorded either as dividend (D.421) or as withdrawals of equity (F.5).

The Bank of England is classified in S.121, including the total banknotes issued. In addition to the Bank of England, several Scottish and Northern Irish banks have the privilege to issue under, severe conditions, banknotes. These banknotes are considered as a liability of these banks and rerouted to the total stock of issued banknotes.

*Findings and conclusions*

Eurostat took note of the current situation.

5.1.4. Review of the questionnaire on public corporations

*Introduction*

The questionnaire was discussed during the 2013 and 2015 visits. In the 2016 public corporate questionnaire, a list of 159 corporations have been transmitted. This list includes entities at a group level. In addition, the questionnaire includes the reporting of several units classified with a NACE code O.

[14] The ONS has included EDP tables 2 in the October 2017 notification. Eurostat considers this action point as closed.

*Discussion*

Although, the information provided, on a group level for public corporations, avoids double counting of liabilities, it does not give a detailed view of all institutional units classified outside government. It is furthermore not in line with the instructions of the table.

The approach on individual units would probably also allow realising the 50% test on unit level, which must be carried out on an institutional unit basis. The individual recording on an institutional unit basis is recommended. The ONS would not like to apply this approach on financial institutions considering the size of such financial groups and the number of units composing them.

The recording of public corporations under the NACE code O should be avoided as this code has to be applied on government units. Eurostat thought it possible that some of the public corporations recorded under NACE code O were non-market in nature rather than market producers.

*Findings and conclusions*

***Action points 15****:* In the light of the arguments developed by Eurostat, the UK Statistical authorities will review carefully the sector classification of all public entities currently classified in NACE O, such as Companies House, Driving and Vehicle Standards Agency, HM Land Registry, Medicines and Health Products Regulatory Agency, Patent Office, Registers of Scotland and Wales Audit Office. Additionally, the UK Statistical Authorities will reflect on whether the British Council could indeed be seen as a market producer providing education or whether its main purpose is rather of a non-market nature.

*Deadline: December 2017*[15].

***Action points 16:*** Acknowledging the arguments put forward by ONS, Eurostat recommends that the questionnaire on public controlled companies shows units on an institutional unit basis rather than on a group basis, for non-financial corporations. This will allow reporting the 50 per cent test as required. Reporting financial corporations on a group basis is considered acceptable, though (thus limiting the number of entries, which otherwise could be very large)[16].

*Deadline: December 2017.*

[15] Action point in progress

[16] The ONS has provided the tables on public corporations in the agreed way. Eurostat considers this action point as closed

## 5.2. Implementation of the accrual principle

### 5.2.1. Taxes and social contributions

*Introduction*

In February 2017, the UK statistical authorities introduced a new time-adjusted cash (TAC) methodology for accruing the receipts related to Corporation Tax, Bank Corporation Tax Surcharge and the Bank Levy. Prior to February 2017, cash receipts were used for the Corporation Tax and the Bank Surcharge as a proxy for accrued revenue. The modified methodology introduced accrued revenue figures by adjusting cash receipts to more accurately reflect the time at which the economic activity relating to the tax receipts took place. A corresponding approach has also been implemented for the Bank Levy to make it consistent with the approach used for Corporation Tax.

*Discussion*

In February 2017, ONS published a methodology document explaining the new time adjusted cash methodology it was introducing for Corporation Tax, Bank Corporation Tax Surcharge and the Bank Levy. The new methodology was implemented after extensive discussions between the ONS, HM Revenue & Customs (HMRC), HM Treasury and the Office for Budget Responsibility (OBR). These discussions focussed on the lags between corporate tax receipts and the economic activity that gave rise to that tax liability.

It was recognised that due to the complexities of corporate tax regimes it was not possible to link individual cash payments with the point at which the liability for that tax payment arose. However, it was also recognised that the previous practise of using cash receipts as a proxy for accrued revenue was not reflecting the underlying economic reality and was difficult to defend, given that attempts are made with other tax revenue, such as VAT and income tax, to time adjust the cash receipts to when the economic event relating to the liability arises.

Quality assurance of corporate tax data

HMRC provide to ONS every month detailed cash and accrued data on all HMRC collected taxes. The cash receipts are taken from HMRC tax systems and the accrued data are time-adjusted cash figures generated using models previously agreed with ONS.

The firm Agreement between ONS and HMRC (supplied separately) sets out the expectations on both HMRC and ONS in regard to the tax data deliveries. HMRC provides briefing on any unusual tax movements within the monthly data supplied and every month a meeting is held between HMRC, ONS, HM Treasury and the Office for Budget Responsibility to review and quality assure the latest tax receipts data. This quality assurance is done through looking at revisions, growth rates, year-on-year movements and comparisons with monthly forecast data. In addition, at an aggregate level, the total reported HMRC cash tax receipts are compared with the amount of monthly cash paid by HMRC to HM Treasury as a further quality assurance measure.

When it comes to quality assuring the accrued tax data for corporate taxes, ONS not only receives the HMRC data but also uses the reported HMRC cash receipts and the tax forecast data from the independent OBR to derive time-adjusted cash (accrued) data. These ONS derived revenue data are then compared with those provided by HMRC to ensure that the two match.

The forecast data used in deriving time-adjusted cash estimates is that produced and published by the independent Office for Budget Responsibility in its Economic and Fiscal Outlook publication. These forecasts are produced twice a year (usually in November and March) and are the official UK Government forecasts. These are consistent with the forecast data reported in the EDP transmission and used by DG ECFIN.

Eurostat underlined that the new UK methodology leads to a recording of substantial tax receivables due to the long time lag between the moment when the economic activity took place and the final payment date of the tax liability. For bigger companies and oil-companies, this time lag can reach up to four months and for small and medium size businesses the time lag can represent up to 21 months. Therefore in addition to the methodological work realised by the ONS, HM Treasury and the OBR, it would be desirable to conduct a study of the consistency between the OBR forecasts and the real tax payments achieved over a certain time period in the past.

*Findings and conclusions*

***Action point 17****:* Eurostat expressed some doubts on the change of recording regarding corporate taxes, from cash to time-adjusted cash which was implemented in the April 2017 notification. While acknowledging that this method is robust to changes in payment schedules (contrary to cash), Eurostat considers that this approach may raise questions with respect to the reliability of the 1st estimate (which in the case of the UK is the October notification as the EDP legislation relates to the financial year which uniquely for the UK is April to March). In order to address this, the U.K. Statistical authorities will provide Eurostat with a study showing the reliability of forecasts versus outcomes of corporate tax over a sufficient number of years (in order to reassure Eurostat of the soundness of the current method and to show that this methodological change does not lead to major revisions after the 1st notification of October T+1). The topic may be raised in the EDPSWG or in the Task Force on methodological issues.

*Deadline: First brief analysis end of June 2017;*
*Detailed analysis before end of September 2017*[17]*.*

[17] The ONS provided the brief and detailed analyses to Eurostat. This has been assessed again during the April 2018 EDP notification and will be monitored in October 2018.

### 5.2.2. Timing of recording of tax expenditures

*Introduction*

Eurostat and the ONS discussed under this agenda point how the ONS record such tax expenditures.

*Discussion*

The UK authorities record payable tax credits annually. These tax credits are added to expenditures and in order to be set-off deducted from revenues.

Nevertheless, there might occur some discrepancies in the recording of such tax credits, due to time lags in the information chain.

*Findings and conclusions*

Eurostat took note of the ONS' explanations.

### 5.2.3. Social contributions / reporting of funded Public sector employee pension schemes (impact on borrowing)

*Introduction*

In the 2014 Budget the government announced a plan to support savers aged 65 years and over with a special rate bond scheme. The bond scheme is operated by National Savings & Investment (NS&I) and is fully backed by government.

*Discussion*

In 2015 (when the pensioner bonds became available), savings bonds offered by the private sector gave much lower rates than the Pensioner Bonds. The interest rate has remained stable in the last 18 months and has been circa 0.5%. The Post Office is currently selling a one year bond with an advertised interest rate of 1.25% and a three year bond with an advertised interest rate of 1.40%. The government backed scheme offered a rate of 2.8% for the one year bond scheme and 4% for the three year bond scheme. The government therefore appears to be deliberately paying participants (certain households) significantly above-market interest rates. This rate is not available to anybody under the age of 65 years and is for ‘households’ only. Possible competitors for the target age group such as SAGA[18] are providing rates that are competitive with the Post Office.

The mechanics of the scheme appears to be as follows: The households invest money via NS&I to purchase either a one or three year bond, the schemes are identical other than the amount of interest being paid. The longer the household invests, the greater the reward to the saver and this scheme reflects this.

[18] Private insurance and investment company

Eurostat took note that a particular pension bond scheme (non-tradable bonds issued in favour of elderly people, including a bonus payment by HM Treasury in the form of interest significantly higher than market rates) is reported in the Maastricht debt (AF.29) as well as in the deficit, on a capitalized interest basis, which Eurostat considers is appropriate.

The question of how to record the bonus on the interest paid has been raised by the ONS: whether the bonus part of the interest payment might be recorded not as D41, but as D.759 for the one and the three year bond or as D.759 for the one year bond and as D.99 for the three year bond.

Eurostat and the ONS discussed several details of this saving scheme, notably the quality of the issuer of the bonds, the transferability of the bonds and the possible market value.

It appears that these bonds are not transferable and therefore do not have any settled market value. Therefore is Eurostat's view that the recording of the interest should be separated between an observed market interest paid by the borrower (recorded as D.41) and the bonus part of the interest as D.7 as a transfer.

*Findings and conclusions*

*Main finding:* Eurostat took note that a particular pension bond scheme (non-tradable bonds issued in favour of elderly people, including a bonus payment by HM Treasury in the form of interest significantly higher than market rates) is reported in the Maastricht debt (AF.29) as well as in the deficit, on a capitalized interest basis, which Eurostat considers is appropriate. Eurostat encourages partitioning the capitalized interest between a gift component (D.7) and an interest (D.41) component.

### 5.2.4. Recording of interest

*Introduction*

Eurostat and the ONS discussed the recording of accrued interest as well as interest and penalty payments on restructured housing revenue accounts of local governments.

*Discussion*

The discussion first concerned the accrual recording of interest payments of inflation linked gilts. The inflation based portion of the interest is only known after publication of the RPI, which impacts the stock of bonds as well as the interest. The ONS calculates the RPI monthly and applies the value on the respective gilts. According to the ONS, the volatility of the RPI explains the validity of interest recorded in EDP table 1.

Secondly, England and Wales have in 2012 and in 2015 reformed the rules for the housing revenue accounts. This reform led to the early repayment of loans and consequently to the payment of penalties by local authorities. Subsequently, new loans were extended by central government to the local authorities. The ONS recorded these amounts as interest payment (D.41) and not as penalties. Taking into account the nature of the payments, the amounts should be split into interest and penalty, where the ONS can decide whether to record a D.75

or a D.39 entry. This recording would be aligned with the recording as P.2 by the banks (counterpart of the loans).

Eurostat recommends applying the recent DEM recommendation on the recording of such transactions, where the ONS should choose between the two options of recording either (1) recording the interest plus other current transfer or (2) interest plus subsidies.

*Findings and conclusions*

***Action point 18****:* The ONS will revise the treatment of penalties on early debt redemption between central and local government (in the context of HRA restructuring) in the light of the forthcoming guidance note currently examined by the dedicated expert meeting.

*Deadline: Post guidance note publication*

#### 5.2.5. Other flows in F.8 assets and liabilities

*Introduction*

Eurostat and the ONS discussed the observed variations of F.8 assets and liabilities in ESA table 27.

*Discussion*

The ONS explained that these variations and revisions are due to foreign currency and reclassification since 2007. Several assets are linked to military operations. After having investigated these variations, the ONS recognises that reconciliation of IFRS and OSCAR data for stocks and flows can only be partially realised, due to timing differences, the time of recording and the application of the accrual principal only for a portion of the assets. Therefore, the ONS can only reconcile a portion of the flows. Nonetheless, the ONS should remove the other change in volume in AF.8 originated by compilation issues.

*Findings and conclusions*

***Action point 19****:* The ONS should remove the other change in volume in AF.8 originated by compilation issues.

*Deadline: End of September 2017*[19]

### 5.3. Compilation issues and Revisions

#### 5.3.1. Consolidation in ESA table 27

*Introduction*

Under this item Eurostat and the ONS discussed the consequences of reporting of consolidated data.

[19] The ONS reviewed the compilation process of Other Accounts Receivables (AF.8) for the October 2017 EDP notification. This review had led to revisions of time series. Eurostat considers this action point as closed.

*Discussion*

Eurostat and the ONS discussed the data compilation in ESA table 27. The consolidated amounts transmitted do not allow analysing the real flows, leading also to the recording of negative amounts.

Therefore, Eurostat invites the ONS to provide non-consolidated general government data.

*Findings and conclusions*

***Action point 20**:* The ONS will aim at improving the quarterly financial accounts data compilation in order to provide non-consolidated general government data, which are also required by the legislation, aside from consolidated data.

*Deadline: March 2018*

#### 5.3.2. Calculation of individual and collective consumption in ESA table 2 and 11

*Introduction*

Eurostat and the ONS have discussed differences between the recording in GFS tables 2 and 11.

*Discussion*

Eurostat and the ONS discussed the alignment of GFS tables in order to ensure the comparability of the data, in particular between ESA tables 2 and 11. This concerns the individual and collective consumption of local governments.

*Findings and conclusions*

***Action point 21***: GFS tables should be aligned with the measures of individual and collective consumption of table 11 (for local government).[20]

*Deadline: End of December 2017*

#### 5.3.3. Data sources for dividend payments of housing association and housing revenue accounts

*Introduction*

Under this item, Eurostat and the ONS discussed the recording of dividend payments of housing revenue account, which represent a large portion of dividends received by government.

[20] The ONS has reviewed the process and delivered in December 2017 almost consistent data. Eurostat considers this action point as closed.

*Discussion and methodological analysis*

The housing revenue accounts consist of units operating on the local level. They are set-up and controlled by local governments. These housing accounts are ring-fenced against the local government accounts.

A large number of these housing bodies are reporting positive annual results, which are transferred to local authorities. Although, some of these housing bodies report losses, the aggregation leads to the recording of substantial dividends.

Housing associations, which are distinct housing bodies separate from the local government housing activity undertaken through the Housing Revenue account, are currently classified as Public Non-financial Corporations (S.11001)[21].

*Findings and conclusions*

***Action point 22:*** ONS will provide Eurostat with the rationale for its current classification of housing associations.

*Deadline: December 2017*[22]

### 5.4. Re-routing

*Introduction*

The ONS reported up to the April 2016 EDP notification rerouted transaction in the EDP Questionnaire tables. Since then, there have been no data reported. Eurostat and the ONS discussed the rational of the changes intervened.

*Discussion and methodological analysis*

Rerouting is one of the "arranged transactions" described in ESA 2010. ESA 2010 distinguishes two cases of rerouting. The EDPS WG has discussed this issue during the December 2016 EDPS working group.

First type of rerouting, is defined in ESA 2010 1.73 : "*A transaction that appears to the units involved as taking place directly between units A and C may be recorded in the accounts as taking place indirectly through a third unit B. Thus, the single transaction between A and C is recorded as two transactions: one between A and B, and one between B and C. In this case the transaction is rerouted.*"

For this first case of rerouting, ESA 2010 1.74 gives the example of the social contributions which take the form of a transaction between the employer and the Social Security Funds (or any other social protection unit) but are in national accounts broken down between two series of transactions involving employees, as receiving more revenue from their employer and then retroceding it to the social protection unit.

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21 Subsequent to the Standard Dialogue Visit, revised Housing legislation led the ONS reclassifying English housing associations as Private Non-financial Corporations (S.11002).

22 Action point under discussion

Second type of rerouting is explained in ESA 1.75: "*Another type of rerouting is that of transactions recorded as taking place between two or more institutional units, even though, according to the parties involved, no transaction takes place at all. An example is the treatment of property income earned on certain insurance funds, which is retained by insurance enterprises. The system records this property income as being paid by insurance enterprises to policyholders, who then pay the same amount back to the insurance enterprises as premium supplements*".

After having recorded a large number of transactions in the past and the reorganisation of the procedures in the UK, the ONS reports no rerouted or rearranged transactions anymore, because these are either B.9 neutral or below the implemented threshold of 0.05% of GDP.

The discussion in the December 2016 EDPS working group will contribute to deliver a new guidance on rerouting reporting. Eurostat invites the ONS to include all rearranged transactions (even if these transactions are B9 neutral or below the current threshold of 0.05% of GDP) in table 13 of the questionnaire related to the EDP tables, in accordance with forthcoming guidelines.

*Findings and conclusions*

***Action point 23: The*** ONS will include all rearranged transactions (even if these transactions are B9 neutral or below the current threshold of 0.05% of GDP) in table 13 of the questionnaire related to the EDP tables, in accordance with forthcoming guidelines. These transactions are currently recorded by ONS within the metadata of the existing table 13.[23]

*Deadline: End of September 2017.*

## 5.5. Financial crisis interventions

### 5.5.1. Recording of claims against the banking sector

*Introduction*

Eurostat and the ONS discussed the nature of claims against the financial sector due to the extraordinary compensation payments made during the financial crisis to several financial institutions.

*Discussion*

The Financial Service Compensation Scheme (FSCS) is the UK's statutory fund of last resort for customers of authorised financial services firms. This means that the FSCS will pay compensation if a firm is unable, or likely to be unable, to pay claims against it. In 2008 and 2009, as a result of the financial crisis, a number of extraordinary compensation payments were made by FSCS. These extraordinary compensation payments concerned:

[23] The October 2017 EDP notification includes the delivery of rerouted/rearranged transactions in questionnaire table 13. Eurostat considers this action point as closed.

- Bradford & Bingley
- Heritable Bank
- Kaupthing, Singer & Friedlander
- Icesave
- London Scottish Bank
- Dunfermline Building Society.

The FSCS is classified in central government and is a levy funded body. The levies that it receives are paid annually by UK authorised financial services firms. Compensation payments by FSCS are usually funded directly from the annual levies. However, in the case of the 2008 and 2009 extraordinary compensation payments the FSCS had insufficient funds to make the necessary payments. The FSCS borrowed from HM Treasury on commercial terms, instead of levying extraordinary contributions from banks.

The ONS considered the compensation payments made available to the specific banks sector as a liability of the banking sector against the FSCS, leading to the recording of tax receivables in the Questionnaire table 5. This takes into account that the final debtor, if the supported financial institution fails, will be the financial sector, which has to compensate the made losses.

Bradford & Bingley was reclassified to central government from July 2010, following the loss of its banking license. As a result of this, the AF.89 (financial claim) related to Bradford & Bingley consolidates within the central government subsector (S.1311) from this date. Prior to this date (in 2008 and 2009) the AF.89 fiscal receivable is recorded with FSCS in central government (S.1311) and the AF.89 fiscal payable with Bradford and Bingley in S.12501 (other public financial intermediaries).

It is worth noting that UK Asset Resolution Ltd. (UKAR) sold £11.8 billion of Bradford & Bingley's loan book in April 2017. This sale will, largely, be used to pay back the FSCS and so in turn HM Treasury. As the intra-central government sector transactions consolidate the overall impact on central government will be B.9 neutral with an increase in cash deposits (AF.22A), matched by a decrease in loan assets (F.4A).

During 2008 and 2009, the UK public sector interventions in the financial corporation sector (S.12) were not limited to compensation payments through FSCS. In addition to these payments, HM Treasury loaned significant amounts of money to both Northern Rock and Bradford & Bingley during 2008 and 2009 to help with the liquidity issues they were facing. Northern Rock was the recipient of £15.6 billion in direct loans during this period and Bradford & Bingley £8.5 billion. The loans attracted interest payments and as of March 2016, £7.5 billion was outstanding of the loan to Northern Rock and £2.5 billion of the loan to Bradford & Bingley. Initially the loans were recorded as central government assets and liabilities of other public financial intermediaries. However, as Northern Rock was reclassified to central government in January 2010 and Bradford & Bingley in July 2010, these loans became consolidated within the central government subsector (S.1311) from 2010 onwards.

Eurostat brought forward a different interpretation of such claims. As the financial institutions received a loan from the FSCS, the claim should be considered as a genuine debt of the specific financial institution and not as a debt of the financial sector. The final resort liability of the financial sector is to be considered as a contingent liability. Eurostat also questioned the recording of a capital tax as well as the capital transfer to and from households.

*Findings and conclusions*

***Action point 24***: In the light of the discussion, the ONS will review the recording of tax claims in table 5 of the questionnaire related to EDP tables, that are linked to the financial crisis, considering the genuine nature of such claims. The ONS will prepare a note reflecting on the appropriateness of the recording in 2008 of matching D.91 (revenue) and D.99 (expenditure) transactions, notably explaining the counterparts of such transactions (counterpart transaction as well as counterpart sector).

*Deadline: End of September 2017*[24]

5.5.2. Classification of the Asset Purchase Facility / Special liquidity scheme

*Introduction*

Eurostat and the ONS discussed the classification of the Asset Purchase Facility and of the closed Special Liquidity Scheme), created for monetary policy purpose.

*Discussion*

**a) Special Liquidity Scheme (SLS)**

The SLS was introduced by the Bank of England in April 2008 in response to the crisis within the financial sector. The Bank of England website described its purpose as: "to improve the liquidity position of the banking system by allowing banks and building societies to swap their high quality mortgage-backed and other securities for UK Treasury Bills for up to three years. The Scheme was designed to finance part of the overhang of illiquid assets on banks' balance sheets by exchanging them temporarily for more easily tradable assets."

The drawdown period for the SLS closed on 30 January 2009, but as the UK Treasury Bills were loaned for up to *3 years* the scheme did not officially close until 30 January 2012. Approximately £185 billion of UK Treasury Bills were loaned through the SLS and exchanged for securities with a nominal value of approximately £290 billion. The difference between the two figures reflecting the "haircut" applied to the collateral and/or any market value difference to nominal value.

More information can be found on the operation of the SLS in the Bank of England Quarterly Report from 2012Q1.

[24] The ONS provided documents on the recording and this action point is still under discussion between Eurostat and the ONS.

**Statistical Treatment of the SLS**

The statistical treatment of the SLS and the background to that treatment is set out in detail in chapter 21 of Public Sector Interventions in the Financial Crisis, an ONS report from 2009.

The transaction in UK Treasury Bills used in the SLS was recorded as stock-lending between central government, the Debt Management Office (DMO) and the Bank of England, the economic ownership being judged to remain with the DMO.

The SLS was set up for the purpose of liquidity, instigated by the Bank of England reflecting the treatment of the central government as the economic owner of the Treasury bills. The duration of the program was short and the risks of losses under the scheme were relatively low. The ONS considers that this treatment is in line with Eurostat's 2009 guidance note on the statistical recording of public interventions to support financial institutions and financial markets during the financial crisis.

It is worth noting that the statistical treatment of the SLS was the subject of extensive discussion nationally and at EU level in 2008 and 2009. This recording has been agreed with Eurostat and discussed within the Financial Accounts Working Group (FAWG, now EDPS WG) and the Committee on Monetary, Financial and Balance of Payment Statistics (CMFB).

The treatment of lending fees to the DMO was as payments for non-market output (P.131) and the treatment of the final payment in lieu of dividend, in April 2012, as a dividend (D.421). This dividend payment was subject to the super-dividend test as defined in ESA 4.55.

Eurostat noted that applying rules on security lending for specially created instruments may be debatable.

**b) Asset Purchase Facility (APF)**

The APF was introduced by the Bank of England in January 2009. It was introduced as the vehicle to undertake Quantitative Easing (QE) and was established as a separate company, the Bank of England Asset Purchase Facility Fund Ltd. The APF purchases securities, the vast majority being UK government bonds (gilts), on the secondary markets.

The APF is a tool of the Bank of England's Monetary Policy Committee (MPC). Initially, in 2009, £75 billion was set aside for purchases with a further £75 billion set aside if required. In August 2009 the ceiling of the facility was extended to £175 billion, then in October 2009 to £200 billion. A succession of further extensions in 2011 and 2012 allowed the APF to acquire £375 billion of securities. Each time the MPC has voted to extend the APF, it has written to the Chancellor of the Exchequer who has formally authorised this extension. As of the end of 2016, the APF had spent £428 billion on acquiring £362 billion of gilts (at nominal value) and £5 billion of corporate bonds.

The APF is subject to an indemnity guarantee from HM Treasury, such that HM Treasury is entitled to any profit that the APF eventually makes as well as being responsible for any losses it may incur. There is no fee paid for this indemnity.

The APF realises profits as it is the recipient of large interest payments on the securities it holds. As the APF mainly holds gilts, most of the interest it receives is in the form of coupon payments from central government (the DMO). Although the APF does pay interest on the loan from the Bank of England, these loan interest payments are much lower than the interest received. The APF, in this way, builds up cash reserves. Due to the build-up of cash in the APF, it was decided, in November 2012, that the APF would transfer surplus cash to HM Treasury. Over the course of 2013 the APF transferred approximately £40 billion to HM Treasury and since then it has made regular quarterly transfers.

Although the APF is currently making profits it could incur significant losses in the future when it sells the securities it holds and interest rates have returned to normal. The APF will therefore need to fund this difference in order to pay off the loan it holds with the Bank of England.

In August 2016, the MPC voted to introduce a new element to the APF which it has called the Term Funding Scheme (TFS). The TFS provides cash to eligible financial corporations in exchange for collateral in the form of high-quality securities. The scheme is to run for a period of 4 years. The scheme in many ways is similar to the SLS in that it accepts collateral (valued at market value less a Bank of England defined 'haircut') in exchange for cash. The main difference is that the SLS was lending UK Treasury Bills but the TFS is lending cash.

More information on the APF, and its evolution, is available in three ONS documents, one from 2009, another from 2013 and a final one from 2016.

**Statistical Treatment of the APF**

Although the APF is a legal entity controlled by the Bank of England it is not considered to be an institutional unit as its ability to take economic decisions (as required under ESA 2010 para. 2.12) is tightly circumscribed, with the Bank of England's MPC taking the key decisions regarding the APF. As a result the APF is consolidated with its controlling body, the Bank of England (Central Bank S.121).

The gilts held by the APF remain liabilities of central government and so are recorded within general government debt. Similarly the coupon payments for these gilts impact on general government net borrowing.

When cash transfers from the APF to HM Treasury began in 2013, the ONS concluded that these transfers should be treated as dividend payments from the Bank of England to HM Treasury. As with all dividend payments, these payments are subject to the super-dividend test, which has meant that only some of the cash transfers have been recorded as dividends (D.421) with the remaining transfers recorded as withdrawal of equity. For instance, in 2013, there was £40.2 billion in cash transfers but only £18.6 billion of this was recorded as dividends (D.421) impacting on government net borrowing. In more recent years all transfers have been within the super-dividend limits and so recorded in their entirety as dividends (D.421).

Although there have not yet been any cash transfers in the other direction from HM Treasury to the APF in case of losses, ONS has concluded that should such transfers occur, they will be recorded as capital transfers (D.99) which will impact government borrowing.

The ONS wrote to Eurostat in February 2013 to seek confirmation that the ONS classification judgements were in accordance with ESA 2010 and MGDD. Eurostat confirmed this in a letter, which is published on the Eurostat website[25].

Eurostat took note of the statistical treatment of the APF, classified outside general government (S.121), taking in consideration that the APF was created for monetary policy purposes. Eurostat stressed that operations undertaken on behalf of government are to be rerouted through government according to National account rules, notably when government assumes all the risks and rewards. Eurostat took note that the ONS deviates from this principle because the scheme is deemed part of monetary policy. However, Eurostat would expect that the UK authorities would book a capital transfer, in case APF would record a loss for a given financial year, at time of loss and not time of settlement of the loss.

The introduction of the Term Funding Scheme (TFS) in 2016 once again required the ONS to review the APF in order to come to a classification view on the transactions related to the TFS. The ONS published this decision in October 2016. The ONS concluded that the TFS lending was to be recorded as a financial loan (AF.4) from the Bank of England to the TFS participant (i.e. the eligible financial corporation) with the collateral assets remaining on the balance sheets of the TFS participants. As with all other activity of the APF, the TFS activity is funded through a loan from the Bank of England which in turn is funded through the creation of central bank reserves, an AF.29 liability for the Bank of England.

The ONS publishes monthly data on the APF in table PSA9 of the Public Sector Finances.

During the April 2017 EDP notification, the ONS reported in EDP Questionnaire table 10 dividends paid of £9 billion by the APF to HM Treasury. In the same time, the amount guaranteed by HM Treasury increased almost accordingly.

*Findings and conclusions*

***Main findings***: Eurostat took note of the UK statistical treatment of the Asset Purchase Facility (Special Liquidity Scheme, closed) outside general government (in the S.121 sub-sector), based on the notion that the APF was organized for monetary policy purposes. Eurostat stressed that operations undertaken on behalf of government are to be rerouted through government according to National account rules, notably when government assumes all the risks and rewards. Eurostat took note that the ONS deviates from this principle because the scheme is deemed part of monetary policy. Eurostat however expects that a capital transfer will be booked, in case APF would record a loss for a given financial year, at time of loss and not time of settlement of the loss. The ONS does not expect any material time lag, if such a circumstance of APF losses were to occur, but otherwise agrees with Eurostat.

[25] http://ec.europa.eu/eurostat/documents/1015035/2990735/UK-Treatment-of-BEAPFF-and-flows-btwn-Bank-of-England-HM.pdf/6c26f076-25e7-449a-be9b-f330d2bab265

### 5.5.3. Classification of the British Business Bank enable scheme

*Introduction*

In the 2015 EDP dialogue visit, the asset finance vehicle had been discussed. A first reply has been provided by Eurostat. The aim of the scheme is to facilitate the asset financing for SMEs. Since then this scheme has been amended and renamed 'enable scheme'.

*Discussion*

**Background**

Asset finance is a traditional source of funding for companies, including SMEs. Asset finance can be described as borrowing to buy assets with the assets themselves acting as collateral. Asset finance often resorts to securitisation techniques, where a created/dedicated entity on purpose acquires the legal rights on streams of payments (e.g. payments pertaining to an asset, such as interest and repayments) against cash or other considerations, while the entity funds itself by issuing securities.

Access to asset finance has been severely curtailed in 2008, and has not yet recovered in some segments of the market, notably concerning SMEs. In particular, the UK government considers that smaller SME Funders (independent asset finance companies = IAFC) have found themselves more constrained than before, owing to reductions in large banks' lending, and, for the smaller IAFC, lack of scale to access securitisation or lack of a viable permanent source of new funding.

To solve the problem, the UK government established the Enable scheme designed to provide in a first phase a bridge to the securitisation market for those smaller IAFC. In this first phase, the government sets up an SPE by the intermediate of the British Business Bank. The government lends to the SPE, to refinance the loans originated by the IAFC to finance SME's, replacing commercial banks.

In the second phase, the government SPE will be replaced by a so called Term SPV, which refinances the total amount of the government financing. This Term SPV will act as a simple conduit and will be managed on behalf of the IAFC participating as originators of the underlying assets.

Following the refinancing and the replacement of the government SPE by the Term SPV, government will provide a second loss guarantee of 10% - 20% of the total assets. This guarantee shall be activated only after the junior notes (15% of the total assets) held by the IAFC will have absorbed the first losses, but before any losses will be borne by the senior note holders.

**Classification proposed by the ONS**

*Phase 1*. The British Business Bank, establishing the first phase SPE, is classified in the central government sector. The SPE is established only for the purpose of the specific financing and has no autonomy of decision. Therefore it has to be classified together with the unit establishing it (ESA 2010 2.2), i.e.in the central government sector (S1311).

The financing made available through the SPE will be a bridging loan to be recorded as F41 if the initial maturity is < 1 year and F42 if the initial maturity is > 1year.

The loans provided by government will indirectly impact the Maastricht debt of the central government through the financing of these loans. The interest received by government will be recorded as income and impact B9.

*Phase 2.* The ONS proposes to classify the Term SPV with the establishing mother-company i.e. the IAFC (private sector S.12). The guarantee provided by the government will therefore be recorded as a not standardised guarantee.

*Discussion*

Eurostat underlined that the guarantee provided by government might have an impact on the classification of the Term SPV and will analyse the ONS provided documents.

*Findings and conclusions*

***Action point 25***: Eurostat will provide an 'advice' letter on the 'Enable Scheme' set up by the British Business Bank, which will be published on Eurostat's web site in coordination with the ONS.

*Deadline: End of June 2017*[26]

### 5.6. Energy performance contracts

In 2015, Eurostat published a guidance note on the impact of energy performance contracts (EPCs) in government accounts, after consultation of the EDP Statistics Working Group (EDPS WG) and the DMES. The note specified the rules to be applied for the recording of EPCs in government accounts. It concluded that, in most cases, the capital expenditure undertaken by a special unit (the EPC Provider – Energy Saving Company) on an existing government asset would be recorded as government expenditure (and the assets included in the balance sheet of government), the energy performance contract being split de facto between a capital procurement contract and a service contract.

During the April 2017 EDP notification, the UK authorities informed Eurostat that the ONS makes all efforts to receive the relevant information from local governments. The ONS planned to establish a regular exchange with local authorities with the aim to clarify the statistical treatment and to establish data collection. There are no EPC contracts on central government level.

*Findings and conclusions*

***Main findings:*** Eurostat took note that the ONS is working to establish data sources for EPCs entered into by local government bodies and for the time being there is no substantial information.

[26] Action point under review

For future central government operations, the UK authorities expect substantial clarification from the future Eurostat guidance note, currently under discussion in EDPS working group. In light of this guidance note, the UK authorities will set-up a new framework for government units interested in using EPC contracts.

## 5.7. PPPs – concessions and leases

*Introduction*

Under this item Eurostat and the ONS discussed the classification of specific PPPs, as has been agreed in the 2015 Standard Dialogue Visit.

### 5.7.1. Welsh and Scottish PPP model

a) Scottish PPP model

In the April 2015 dialogue visit, the Scottish PPP framework has been discussed and since then, the ONS has provided to Eurostat its analysis and related documents for the Aberdeen Western Peripheral Road project. Eurostat agreed with the ONS analysis on the classification on government balance sheet of this project. Since then, the Scottish government amended the PPP scheme. This item will thus be under further discussion.

b) Welsh PPP model

Eurostat has received an ex-ante advice request from the ONS on the Welsh PPP model. The ONS has, together with the request, provided detailed information, which is currently under review by Eurostat. The Welsh PPP model is a framework and no final project has been signed.

The ONS has taken a provisional decision on the off balance sheet classification of the Welsh PPP model, based on ESA 2010, the MGDD 2016 and the "Guide to the Statistical Treatment of PPPs" compiled by Eurostat and the European Investment Bank.

Eurostat notes that, according to its 'advice' on the Aberdeen Western Peripheral Road (published), the Scottish PPP model has to be recorded on government balance sheet, consistently with ONS' analysis. Eurostat is currently in the process of analysing the Welsh PPP model, which the ONS considers to be recorded off government balance sheet. Eurostat also took note that there was a new Scottish PPP model (the 'Hub' model).

Beside the general issue raised about the statistical classification of PPP projects, the issue of government control through 'reserved matters' concerning guarantees, dividends, amendments to the memorandum of constitution, shares and shareholder subordinated debt (issuance, redemption, cancellation…), management and control issues, contracts with related parties and insolvency and related matters, have been discussed under item 5.7.2.

*Findings and conclusions*

***Action point 26***: Eurostat notes that, according to its 'advice' on the Aberdeen Western Peripheral Road (published), the Scottish PPP model has to be recorded on government balance sheet, consistently with ONS' analysis. Eurostat is currently in the process of analysing the Welsh PPP model, which the ONS considers to be recorded off government balance sheet. Eurostat also took note that there was a new Scottish PPP model (the 'Hub' model). ONS agreed to provide Eurostat with an example PPP from this new Scottish PPP model for Eurostat to review.

*Deadline: End of June 2017 (Eurostat analysis of Welsh PPP model); End of July 2017 (ONS to provide example Scottish PPP case)*[27].

### 5.7.2. Statistical control through "reserve matters" or "qualified majorities"

*Introduction*

Reserved Matters exist within the Shareholders' Agreement and Articles of Association of UK companies in order that minority shareholders can protect their shareholding by possessing the right to veto certain actions taken by employees of the company.

When these powers of veto are possessed by government, there is the possibility that they could lead to a public sector classification of the company. This has created a degree of uncertainty, and Her Majesty's Government (HMG) is keen to establish whether a template of Reserved Matters that has been drafted would allow a level of protection over the rights and value attached to their company shares while not resulting in a public sector classification of the company.

*Discussion*

The main constitutional document of a UK company is it's Articles of Association (Articles). This is a contract between the company and its shareholders which contains the rules about how the company will be run. It is a legal requirement for limited companies to have Articles and they usually provide shareholders with minimal protection, and reassurance about how the company will be run.

The Companies Act 2006 requires certain decisions to be made by shareholders votes of two main types,

1. Ordinary resolutions which require the approval of over 50% of the shares voted
2. Special resolutions which require the approval of at least 75% of the shares voted.

This leaves minority shareholders exposed. There are laws that provide limited protection to minority shareholders but these can be expensive to enforce and may not achieve adequate redress.

For this reason, if a company has more than one significant shareholder, those shareholders normally protect their rights and the value of their shares by agreeing important matters in a Shareholders' Agreement.

[27] Eurostat provided the advice letter on the Welsh PPP model (WMIM), the model is currently under review and the ONS will provide the amended documentation.
The ONS has provided the documentation, which is currently analysed by Eurostat.

The principal way that shareholders protect themselves is by stipulating actions that company employees cannot take without prior written consent. These are known as Reserved Matters and are stipulated within the Articles of Association and/or the Shareholders' Agreement.

Reserved matters are agreed between shareholders and therefore there is no standard format or wording. However, significant minority shareholders would generally like to have included some veto rights to protect their material interest in the conduct of the business.

As the ONS has not ruled on whether the Reserved Matters generally used by HMG constitute public sector control, a level of uncertainty exists. As such, it is the intention of HMG to create a standard set of Reserved Matters that can be used as a starting point for negotiating Shareholders' Agreements when government wishes to take significant minority shareholdings in companies.

*Findings and conclusions*

***Action point 27***: Eurostat and ONS will jointly reflect on the issue of 'control' of Special Purpose Entities by government through reserve matters of qualified majorities, as laid down in corporate law and standard commercial contracts.

*Deadline: September 2017*[28].

### 5.7.3. New IFRS and IPSAS standard on leases and its impact on GFS

*Introduction*

The ONS raised the issue of the recording of leasing contracts under the amended IFRS standards.

*Discussion*

The new IFRS standard 16, applicable from 2019 onwards, will amend the recording of leasing transactions. The lessor will still have the possibility to record either an operational or a financial lease, while the lessee will record under any circumstances a financial lease. This recording will have an impact on the Maastricht debt. In principle, IPSAS follows the IFRS rules. Nevertheless, the IPSAS framework does not yet take the amended IFRS recording into account.

The difference in recording will have an impact on the UK recording of leasing contracts.

*Findings and conclusions*

***Action point 28***: The UK Statistical authorities and Eurostat will reflect on the consequences, if any, of the new IFRS and IPSAS standards on leases. The U.K. agreed to present the issue at the next EDPS WG in July 2017.[29]

*Deadline: July 2017.*

[28] The ONS has provided the documentation on this issue. Eurostat and the ONS continue to discuss the topic.
[29] This issue has been discussed in the EDPS Working group in July 2017 and Eurostat considers this action point as closed, although there remain potential recording issues, which will be further discussed.

## 5.8. UMTS recording

*Introduction*

Under this item was discussed the recording of UMTS licenses.

*Discussion*

The UK has implemented the recording guidance for UMTS licenses in application of ESA chapter 15, which spread the proceeds over the lifetime of the contract, irrespective of whether the contract was transferable or not. This has been confirmed by the ONS during the April 2017 EDP notification.

*Findings and conclusions*

Eurostat took note that the UMTS (mobile phone licenses) recording is in accordance with the guidance note recently issued.

## 5.9. Energy accounting

### 5.9.1. LCCC (green energy scheme) taxes and subsidies

*Introduction*

In order to develop low carbon electricity production, the UK authorities have introduced the green energy scheme carried out by the Low Carbon Contract Company (LCCC). Eurostat and the ONS discussed the statistical implication of this scheme.

*Discussion*

The LCCC, a government body, levies taxes on electricity suppliers (electricity distribution companies) and distributes the proceeds as subsidies to the electricity producers, through a so called Contract for Difference (CfD). The level of price can either be negotiated between electricity generating company and the LCCC or can be subject to a tender.

The LCCC sets a strike price and pays the difference between the wholesale market price and the strike price to the electricity generating company. If the wholesale market price is above the strike price, the benefitting company pays the difference to the LCCC.

Eurostat enquired whether the payments under the CfD should be considered as a subsidy on products or on production and questioned the role of government.

*Findings and conclusions*

Eurostat and the ONS agreed to further discuss this item[30].

[30] This action point is under discussion between Eurostat and the ONS.

5.9.2. <u>Recording of decommissioning / 2005 transactions</u>

*Introduction*

The ONS has reconsidered the statistical treatment of the UK decommissioning recording in the light of ESA 2010 and the MGDD 2016.

*Discussion*

British nuclear power stations, whose active life span was coming to an end generally remained in the ownership of the power generating companies until the Energy Act 2004 established a new public body, the Nuclear Decommissioning Authority (NDA), to ensure that nuclear legacy for designated sites would be cleaned up safely, securely, cost effectively and in ways that protect the environment.

The NDA commenced operations on 1 April 2005 when it acquired strategic responsibility for the decommissioning of the sites previously owned by British Nuclear Fuels plc (BNFL), the UK Atomic Energy Authority (UKAEA) and several Ministry of Defence (MoD) facilities. The latter two entities were themselves classified to the central government sector (S.1311) whereas BNFL was a public corporation (S.11011).

As a consequence of the Act, BNFL undertook a restructuring exercise, which resulted in a transfer of most of its fixed assets (nuclear power stations and associated infrastructure) to the NDA, for whom it became a decommissioning contractor under the newly formed British Nuclear Group on 1 April 2005. Some of the power stations were still generating, but the majority had been closed by the time of the transfer. The book value of these assets (without taking into account the costs of their decommissioning) was estimated at £6,434m.

While it was still trading, BNFL directly administered a fund with the aim of building up reserves for decommissioning, the Nuclear Liabilities Investment Portfolio (NLIP). The fund mainly invested in gilts and was consolidated within BNFL's accounts. The restructuring involved the surrender of £3,945m worth of assets held in NLIP to the UK Government.

The first £682m of gilts were transferred in April 2005 but following the European Commission's (EC) decision to conduct a formal State Aid investigation into the creation and funding of the NDA and the advantage provided to BNFL by the UK Government, no further financial assets were transferred that year. Following the European Commission's approval of the establishment of the NDA, the final stages of the restructuring became effective on 31 March 2006 with a transfer of the remaining £3,263m of gilts, equity and cash.

**Treatment in the accounts**

At the time these events were taking place, the statistical framework in existence did not contemplate the possibility of very large decommissioning costs; general guidance was only given on how to treat costs of ownership transfer upon the disposal of assets. ONS attempted to reflect the economic reality by netting off the net book value of fixed assets (£6,434m) and estimated decommissioning obligations (£22,013m) to obtain the market value of the transferred assets (£ -15,579m). The deal was recorded by imputing a (negative) capital transfer (D.99) from BNFL (S.11001) to the NDA and other relevant government bodies (S.1311) in 2005. The NDA was assumed to have immediately used these transfers to purchase assets worth £ -15,579m via gross fixed capital formation (P.51g). Additionally, the surrender of NLIP was recorded as a positive capital transfer of £3,945m to S.1311. All of the subsequent decommissioning activity undertaken by the NDA was recorded on the actual expenditure basis as capital formation (P.51g, matched with capital consumption P.51c) within the government sector, thereby increasing its net borrowing (B.9g). The methodology opened up some discussions owing to the negative market value, which did not fit comfortably for a produced asset.

With the publication of the 2016 edition of the Manual on Government Deficit and Debt, ONS revisited the treatment of this transfer. The solution described above was replaced with a transfer (D.99) of fixed assets with a positive net book value of £6,434m, which was then recorded as gross fixed capital formation (P.51g) in S.1311 (positive, acquisition) and in S.11001 (negative, disposal). An additional P.51g entry in S.1311 reflected £219m of actual decommissioning expenditure, with an imputed D.99 entry from S.1101 to S.1311.

The transition to the new approach of accounting for decommissioning costs led to in effect two principal differences. Firstly, the value of the power stations transferred in 2005 no longer implicitly includes the provisional cost of their future decommissioning (£22bn), implying a transfer of an asset with a positive residual value (£6.4bn). Secondly, the transfer of NLIP is now considered an advance for future work – in that way, a one-off capital transfer of £3.9bn is replaced with a series of smaller imputed transfers, each offsetting the actual expenditure on decommissioning in a particular time period.

While Eurostat agreed with the treatment of the assets, it reflected that the previous recording had some merits. ONS pointed out that the new MGDD chapter seemed very clear in respect to the required recording for the transfer of assets for decommissioning.

*Findings and conclusions*

Eurostat took note of the recording of transactions carried out in 2005 related to the decommissioning of nuclear reactors. Eurostat agrees that the transfer of financial assets is to be recorded as a financial advance (rather than a capital transfer at inception as in the previous recording). Eurostat takes note that the current recording is in line with the current text of the MGDD and abandons the previous recording that showed a negative non-financial asset in government accounts (as explicitly prescribed by SNA 2008). This new recording also implies abandoning recording a capital transfer expenditure from government to the BNFL (reflecting the excess of future decommissioning costs obligations over the value of the fixed assets transferred, with a matching entry in acquisition of fixed assets, which is B.9 neutral) and, in contrast, entails the recording of a capital transfer revenue from BNFL to government (matched by an acquisition of fixed assets, which is also B.9 neutral).

### 5.9.3. Hinkley Point nuclear power plant

*Introduction*

The Hinkley Point project is to build a twin reactor of 1,600 MW each in Somerset. Initial discussions started in 2008. In September 2016 final UK government approval has been given and the final legal documentation has been signed. The initial work has been started early 2017. At this time it is now possible to assess the final statistical treatment of the project.

*Discussion*

The classification of this project faces the difficulty that it does not match completely the criteria neither for a PPP nor for a concession set out in ESA 2010, MGDD 2016 or the EIB / Eurostat guide for PPPs.

The ONS has classified the project as a concession, the project company in the private sector and the assets off government balance sheet for the following reasons:

*Construction risk*
The construction risk is borne by the project company. No government compensation has been negotiated for construction delay or increased costs (ESA 2010 20.283).

In the contrary, if the construction will be realised below the forecast cost agreed in the financial model, then a gain share mechanism will apply. The first billion of gain will be shared on a 50 % basis between the project company and the LCCC. Above £ 1.0 bn, the LCCC will obtain 75 %. These gains will be applied to reduce the Contract for difference (CFD) strike price (ESA 20.284).

In addition, there is an equity gain share on the sale of equity by the initial shareholders. Up to a threshold, LCCC will capture 30 % of the equity gain and above this threshold LCCC will capture 60 % of potential gains.

*Availability risk*
The availability risk is fully taken by the project companies. The strike price will only be payable on produced electricity sold in the market. If NNBG sells the electricity below the wholesale price, NNBG will receive only the difference between the wholesale market price and the strike price, reducing the revenue below the strike price (ESA 20.283 and MGDD 2016 VI.3.1.5 §14).

*Demand risk*
The demand risk will be borne by the project company NNBG. There is no obligation for the LCC or any electricity supplier to purchase electricity from Hinkley Point. If NNBG does not succeed to sell any electricity in the wholesale market, it will receive no payments under the CFD agreement (ESA 20.283 and MGDD 2016 VI.3.1.5 §14).

*Other risks*
- Decommissioning risks
The government is the ultimate guarantor for the decommissioning of nuclear sites. Therefore every nuclear operator has to build a Funded Decommissioning Plan (FDP), which has to be submitted to the Secretary of State. This plan will be adapted, from time to time, to reflect the estimated future cost coverage by the FDP. The FDP is based on the so called P80 costs (definition of future decommissioning costs) plus 25 %, having the aim to reduce the possible cost for the government.

- Waste Transfer Contract
The contract covers the future expenditure by the government on the management and disposal of the spent fuel and intermediate level waste. These costs will be covered by future payments from NNBG. The cap on these costs includes a Risk Premium. The payments are expected to be made around year 2100 and the costs incurred between year 2100 and 2140. The signature of such a Waste Transfer Contract is mandatory for every nuclear plant operator.

- Qualifying Shutdown Event (QSE)
The Qualifying Shutdown Event arises if a UK, EU or International competent authority decides the shutdown of the Hinkley Point plant. In this case, the government will have to pay compensation. This excludes reasons like health, nuclear safety, security, environmental, nuclear transport or nuclear safeguards. The QSE may take the form of either a put option from NNBH to the government or a call option expressed by the government. Each of these options will lead to the transfer of NNBG to the government against the payment of compensation.

Compensation will also be due, if the facility is shut down due to nuclear third party liability insurance circumstances, including as a result of the UK government not approving alternative arrangements.

- *Change in law*
Several clearly defined Qualifying Changes in Law (QCIL) will protect NNBG. These include additional taxes, except income taxes; disproportionate effect on operations; undue regulatory changes. The claim can only be introduced if it exceeds cumulated £ 50 m (2012 prices + IPC).

In these cases either the CFD strike price will be adjusted or compensation is paid directly by the government.

Eurostat raised three major aspects to be considered for the classification. There are some rewards staying with the LCCC (c.f. item 5.9.2) and the CfD provisions might not be considered as market. In addition, under IFRS, the CfD might be considered as a derivative transaction. Finally, the guarantor for the decommissioning risk remains the central government. Thus, Eurostat suggested factors that may point at an on-balance sheet treatment, also suggesting testing if Hinkley Point was passing the PPP criteria, as the arrangement taken in its totality may be seen as a PPP. ONS will provide additional material to that provided to Eurostat in November 2015.

*Findings and conclusions*

***Action point 29***: Eurostat and ONS exchanged views on the Hinkley Point nuclear plant project. Eurostat takes note that ONS discussed this issue in the Economic Statistics Classification Committee, which decided to classify this project as a concession and the asset outside government balance sheet. Eurostat suggested factors that may point at an on-balance sheet treatment, also suggesting testing if Hinkley Point was passing the PPP criteria, as the arrangement taken in its totality may be seen as a PPP. ONS will provide additional material to that provided to Eurostat in November 2015. This additional material will further demonstrate the rational for their classification (also taking into account the latest classification rules for PPPs and Eurostat will subsequently provide an official advice.

*Deadline: September 2017*[31].

### 5.9.4. ETS - emission trading scheme

*Introduction*

Under this item Eurostat and the ONS discussed the ETS scheme and the recording of the scheme in the UK.

*Discussion*

The EU ETS is the largest multi-country, multi-sector greenhouse gas emissions trading system in the world. It includes more than 11,000 power stations and industrial plants across the EU with around 1,000 of these in the UK. These include power stations, oil refineries, offshore platforms and industries that produce iron and steel, cement and lime, paper, glass, ceramics and chemicals.

Other organisations, including universities and hospitals, may also be covered by the EU ETS depending upon the combustion capacity of equipment at their sites. Aviation operators flying into or from a European airport are also covered by the EU ETS.

The EU guidance explains the EU's cap and trade system, including details of the phases of delivery of the System. It provides information on the UK's application for Phase III free allowances via its National Implementation Measures (NIMs), as well as details of compliance and verification. There are also sections on emissions regulation for the aviation industry and the UK's Small Emitters and Hospitals Opt-out Scheme.

*Findings and conclusions*

***Action point 30***: The ONS will submit a table on Emission trading schemes following Eurostat's template[32].

*Deadline: July 2017.*

[31] The ONS has provided the additional documentation, which is under discussion.
[32] The ONS has submitted the ETS template and Eurostat considers this action point as closed.

# 6. OTHER ISSUES

## 6.1. Planned future operations - Securitisation programmes

*Introduction*

HM Government has been pursuing a sale of the Pre-Browne Income Contingent Student Loans (“ICR Loans”) as announced by the Chancellor in the 2016 Budget. HMG intends to achieve this by selling the ICR Loans to a new English-domiciled company (“the Issuer”), which will issue one or more debt securities to fund the purchase.

HMG is looking to raise £12bn over 5 years by undertaking a series of sales. The first sale will involve the earliest of the ICR Loans – those that entered repayment in 2002-2006. The face value of this book (after certain exclusions) is £4.35bn and the market value is currently expected to be 50-58% of nominal value.

*Discussion*

ICR Loans were introduced in 1998, replacing the ‘mortgage style’ scheme. The loans were issued for the first time to new borrowers entering higher education in September 1998 and are advanced to English and EU borrowers studying in English higher education institutions. Loans are also made to students resident in Northern Ireland, Scotland and Wales, although these loans do not form part of the proposed sale process.

Repayment under an ICR loan becomes due in the April following the end of the borrower’s course (known as Statutory Repayment Due Date or ‘SRDD'). ICR loans do not include a fixed amortisation schedule. Repayment is fully dependent upon the income level of the borrower – a fixed percentage (currently 9%) of the borrower’s income above a set ‘threshold level’ (equal to £17,775 as of April 2017), is used to reduce the loan balance. No repayments are made if the borrower earns less than the threshold level, is unemployed or has taken a career break. The borrower’s liability to repay the loan in full is cancelled upon the earlier of:

- the borrower reaching the age of 65 (or 25 years after SRDD for loans originated after 2006) ;
- the death of the borrower or the borrower becoming unfit to work due to disability.

**Sale Structure**

Under a securitisation structure, the portfolio of loans is sold to the Issuer. The Issuer then receives all cash-flows from the student loan borrowers beyond a certain reference date. Upon receipt of the loans at the inception of the transaction, the Issuer simultaneously sells notes (“Securitisation Notes”) to investors. The Issuer uses the cash proceeds from the Securitisation Notes to buy the portfolio of loans from the UK Government. Full legal title to the loans will be transferred to the Issuer upon sale.

Different tranches or classes of Securitisation Notes are sold, each offering investors a different risk and return profile. Once the cash-flows have been identified by the UK Government, the Issuer pays to noteholders the interest and principal owed on the Securitisation Notes via a priority payment waterfall, with the Class A noteholders paid senior (following the payment of servicer fees and other senior expenses) and junior investors (Class X noteholders) subordinated. If there is insufficient cash-flow, then payments owed on the Securitisation Notes are not made to investors. There is no obligation on the UK Government to make up any shortfall should the loans economically underperform.

**Structure of the Issuer**

The Issuer will be established as a new, bankruptcy remote, English-domiciled company. The Issuer will be established specifically for the purpose of the transaction by a third party (known as the "Corporate Services Provider") as an independent legal entity with an independent legal status and an independent fiduciary board of directors. The Corporate Services Provider will also provide services to the Issuer including preparing its accounts and tax returns, opening bank accounts, providing directors and its registered office through a corporate services agreement.

The sole shareholder of the Issuer will be a second new, bankruptcy remote English-domiciled company ("HoldCo") that will also be established by the Corporate Services Provider. HoldCo's only purpose will be to own the Issuer and to pass any proceeds received up to its owner. HoldCo will be owned by a share trust established by the Corporate Services Provider, the proceeds of which will be applied by the share trust for charitable purposes. There will be no other owners or shareholder in HoldCo and it will not undertake any other functions. The use of HoldCo as an intermediary holding company is to ensure that the shares of the Issuer are ring fenced from any other assets or functions of the share trustee and therefore remote from any share trust bankruptcy.

The share trust is the ultimate beneficial owner of the Issuer. The Issuer is established in this way to ensure that it is fully separate from the UK Government. The UK Government will have no shareholding, voting rights or other interests in the Issuer and will have no representation on the board of the Issuer or ability to decide or influence the composition of the board.

The ONS has raised with Eurostat the EU regulation on securitisation programs and Eurostat underlined that the current EU regulation on government originated or sponsored securitisation programmes needs to comply with very strict requirements. The EU regulation No 575/2013 of the European Parliament and of the Council of 26 June 2013 Title II article 405 describes the requirements of minimum 5% retained interest of the issuer / originator. In this case the planned UK securitisation would not comply with the EU regulation and any with the EU regulation. The ONS wondered to what extend the EU regulation would not imply that all securitisation had to be recorded by government on balance sheet as debt.

Eurostat will reflect on this issue. In addition the ONS will examine whether it is appropriate to record a capital transfer expenditure (for any loss), in application of ESA 20.229.

*Findings and conclusions*

***Action point 30***: Eurostat will reflect about the statistical implications of the EU legislation on Securitisation programmes (imposing 5% credit risk retention (CRR) by the originator/sponsor of such securitisations) for the correct application of Eurostat's guidelines laid out in the MGDD.

*Deadline: November 2017*[33].

***Action point 31***: In the context of the securitization of student loans, the ONS will examine whether it is appropriate to record a capital transfer expenditure (for any loss), in application of ESA 2010 § 20.229.

*Deadline: November 2017*[34].

### 6.2. ESA 2010 Transmission Programme

There have not been any major problems recently with the UK tables, and some technical issues had been solved bilaterally between the Eurostat GFS team and the UK authorities. In case there will be some points which need further discussion the GFS team of Eurostat will contact the UK authorities bilaterally.

### 6.3. Any other business

There was no other business to discuss.

[33] This action point is under discussion between Eurostat and the ONS.
[34] This action point is under discussion between Eurostat and the ONS.

# ANNEX: LIST OF PARTICIPANTS

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## Eurostat EDP dialogue visit to the UK, 16 – 17 May 2017

*Starting on 16 May at 9:00*

## AGENDA