University of Aberdeen Business School
Edward Wright Building
Aberdeen AB24 3QY
Email: d.heald@abdn.ac.uk

Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street West
Toronto
Ontario
Canada M5V 3H2

1 August 2008

Dear Sir,

Consultation Paper: Accounting and Financial Reporting for Service Concession Arrangements

1. I am Professor of Accountancy at the University of Aberdeen where my research specialisms are in public sector accounting, auditing and expenditure management. Information about that work, which includes accounting for service concessions (Private Finance Initiative in UK terminology), can be found at www.davidheald.com. I am a member of the United Kingdom's Financial Reporting Advisory Board (which has submitted comments on this Consultation Paper) and a specialist adviser to the Treasury Committee of the UK House of Commons. The views expressed in this comment letter are mine alone and should not be attributed to any of the above-mentioned organisations.

2. I welcome the publication of this wide-ranging Consultation Paper and the opportunity to comment. I have found the comprehensive analysis most helpful in clarifying my own views on these complex and important matters. Given where public sector client accounting now is - as opposed to where it might have been - I support IPSASB's decision to adopt what might be described as 'the mirror image of IFRIC 12 treatment'. Given that IFRS provides no direct guidance on service concession accounting for public sector clients, this approach has also been adopted by the UK Treasury and the Financial Reporting Advisory Board so that the United Kingdom can move the anchor of its government accounting from UK GAAP to IFRS in 2009-10. This involves a change from 'risks and rewards' to 'control' as the criterion as to whether a service concession asset will be on the balance sheet of the public sector client.

3. I appreciate the difficulties that regulatory bodies face in the drafting of documents that go into the public domain, but there are dangers that avoiding certain issues or having recourse to coded language may damage public understanding of important accounting issues. The following statements relate specifically to the UK experience[1] but my understanding is that they may resonate in some other countries:

   - The unsatisfactory nature of service concession accounting is not primarily a technical accounting problem but attributable to governments wishing to keep privately

[1] See D. Heald and G. Georgiou, "The Regulation and Substance of PPP Accounting', mimeo, 2008, attached to this comment letter.

financed assets off public sector balance sheets and/or outside fiscal rules. This leads to the design of concession arrangements around the accounting rules (sacrificing some potential Value-for-Money gains) and/or manipulation of accounting treatment (facilitated in the United Kingdom by the existence of the Treasury Technical Note 1 (Revised) (1999) in addition to the Accounting Standards Board's (1998) FRS 5A). Arbitrage between these two pronouncements, with the former being more permissive of Off-balance sheet treatment by the public sector client, has contributed to the extensive occurrence of Off-Off treatment.[2]

- The pattern of On-treatment by public sector clients appears to owe more to the control framework under which they operate than to objective differences between the distribution of risks and rewards on particular concessions. This factor has interacted with differences of approach between the National Audit Office (which has insisted on On-balance sheet treatment for most prisons and roads) and the appointed auditors of the Audit Commission (a mixture of private firms and Audit Commission employees who exercise independent judgement); almost all schools and hospitals in England are Off-balance sheet. An extensive business has developed whereby the potential grantor's auditors and/or audit firms acting as consultants give views on accounting treatments in advance of funding/consents being approved; often funding/consents would not be available were there to be On-balance sheet treatment.

- The growing importance of fiscal rules and fiscal surveillance, especially for those countries within the European Union, draws attention to the significance of national accounts treatment. Whilst following financial reporting in using the risks and rewards criterion, Eurostat's guidance restricts the risks considered to construction risk and availability risk, thus making Off-balance sheet more likely than under either the UK's Treasury Technical Note 1 (Revised) or FRS 5A. This was the politically desired outcome, and has contributed to IMF concerns about the fiscal risks attached to service concession arrangements.

I would not expect IPSASB to be explicit about such regulatory arbitrage, or the motivations for it, but the context is fundamentally important and affects how the implications for new proposals based on 'control' are thought through.

4. I was disappointed not to find in the Consultation Paper an extended discussion of how, in the context of service concession arrangements, 'control' differs from 'risks and rewards'. Paragraph 21 states:

> … The difficulty in accounting for these [service concession] arrangements results from a more even *sharing* between the grantor and the operator of the risks, responsibilities, benefits, and control of the underlying infrastructure or public facility, and the delivery of the associated services. This raises the question - which party to the arrangement should report the underlying infrastructure or public facility as an asset in their financial statements.

This statement defines service concession arrangements in terms of both 'risks and rewards' (though the term 'benefit' is used) and of 'control' (with the term 'responsibilities' also being used). In the United Kingdom it is widely expected that the 2009-10 move to IFRS will bring On-balance sheet to the public sector client most service concession

[2] Page 3 of the Consultation Paper refers to 'even *occasionally* resulting in the property not being reported as property, plant and equipment by either the public sector entity or the private sector entity' (emphasis added). In my view, this understates the extent of this practice.

assets that are currently Off. My view is that this is not inherently a result of control replacing risk and reward but a consequence of previously bad accounting being eliminated. It is more difficult to think of service concessions that would have been properly Off under FRS 5A but On under the IFRIC 12 mirror-image treatment. Given that national accounts treatment will continue to be on a risks and rewards criterion, and that revisions to Eurostat rules follow totally different processes and timescales to those for financial reporting standards, this matter has practical importance for public sector clients that will follow IFRS for their financial statements but may also be required to provide information on a national accounts basis.

5. I can understand why the Board sees appeal in having two control criteria, one over use and the other over residual interest, as these represent two well-understood dimensions of service concession arrangements. However, given the prior history to which I refer above, I fear that having two control criteria may make it easier to design projects around the accounting standards to achieve Off-balance sheet treatment for the grantor. As mentioned above, this may involve sacrificing some potential Value-for-Money gains by sub-optimal contract design or by finding some artificial means to arbitrage the accounting standards. If there are two control criteria, it is imperative that IFRIC 12's wording of 'significant residual interest' be used; residual interest that is not significant should not influence the accounting decision. I commend the clarity of the flowchart developed by the UK Treasury to explain mirror-image treatment under IFRIC 12.

6. The transfer of construction risk to the private sector consortium, and in particular to its construction partner, is one of the mechanisms through which the public sector client can potentially achieve Value-for-Money gains from service concession arrangements. Accordingly, unless there is clear evidence in a particular case that construction risk remains with the grantor, my view is that the timing of recognition should be when the property first comes into use. Accordingly, I disagree with the view in paragraphs 106-112 and support the existing guidance provided by the UK Accounting Standards Board in FRS 5A.

7. The reputation of service concession arrangements has been damaged by manipulated accounting and inadequate transparency which have together clouded debates about whether they generate Value for Money. There should be a disclosure requirement on public sector grantors so that their annual report and accounts disclose the name, address and tax domicile of the private sector operator of each service concession arrangement, its duration and purpose, and - in all cases where the property is not on the balance sheet of the grantor - whether it is on the balance sheet of the private sector operator (usually a Special Purpose Vehicle) and of ultimate parents. These disclosures will enhance transparency and provide safeguards against new forms of accounting manipulation.

Yours sincerely

Professor David Heald

Attachment: "The Regulation and Substance of PPP Accounting", mimeo, 2008.

The Regulation and Substance of Accounting for Public-Private Partnerships

David Heald (University of Aberdeen) and George Georgiou (University of Birmingham)

Paper presented at the Financial Reporting and Communication Unit's 10th Annual Conference, Cardiff Business School, 3-4 July 2008

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Contact author: Professor David Heald, University of Aberdeen Business School, Edward Wright Building, Aberdeen AB24 3QY, Scotland, United Kingdom. Email: d.heald@abdn.ac.uk

1. Introduction

Ethics is not only a question of acting correctly. It is a matter of not trying to avoid regulation even if one thinks one can get away with it (de Rothschild 2008).

Much of the international attention devoted to Public-Private Partnerships (PPP) derives from public policy concerns about perceived or actual deterioration in those infrastructures believed to be prerequisites for sustained economic growth. This occurs in both industrialized countries and developing countries. A commentator in the *Financial Times* recently wrote about deteriorating US public infrastructure:

> … unlike European countries including the UK, the US shows little sign of finding the will or the funding mechanisms to maintain what it has or to build anew. Mr Schwarzenegger spoke enviously of public-private partnerships in both Canada and the UK that have enabled these countries to start redressing their inadequacies (Gapper 2008).

There is implied encouragement for the United States to adopt the PPP model in imitation of certain European countries. The United Kingdom pioneered the use of private finance for public infrastructure in the 1990s, though there were earlier precedents, particularly in Francophone and Spanish-speaking countries. International agencies for economic development in developing countries often promote PPPs as a funding mechanism, thus illustrating the world-wide importance of the accounting and regulatory issues addressed in this paper (Grimsey and Lewis 2007, Hemming et al 2006, Akitoby et al 2007).

Two issues have figured prominently in the recent literature about Private Finance Initiative (PFI) projects, namely whether they deliver Value-for-Money (VFM) and how they should be accounted for, particularly by the public sector client (Heald, 2003). Governments in many countries have proclaimed the efficiency benefits of PFI but an attraction to governments has been that the PFI brings new capital assets without any public expenditure scoring at the acquisition date.

At this early stage, it is essential to clear away some terminological undergrowth which otherwise confuses debate. The UK Treasury (2008a) has defined terms in the following way:

> Public private partnerships (PPPs) are arrangements typified by joint working between the public and private sector. In the broadest sense, PPPs can cover all types of collaboration across the interface between the public and private sectors to deliver policies, services and infrastructure. Where delivery of public services involves private sector investment in infrastructure, the most common form of PPP is the Private finance initiative.

In the UK research literature and in UK policy circles, the term Private Finance Initiative (PFI) dominates in relation to service concession arrangements. Internationally, however, PPP is characteristically used instead and that practice will be adopted in this paper, which concentrates on circumstances in which capital asset acquisition/transfer is centrally involved.

Debates about infrastructure deficiencies typically contain two strands. First, there are privately or socially profitable investments that are not being undertaken because of some financial or institutional constraint. It is necessary to pinpoint these constraints because otherwise discussion of remedies proceeds in a vacuum. Sometimes the constraint is said to be the inability of public authorities to manage and deliver infrastructure projects. Sometimes the constraint is said to be that projects are 'not affordable' because of budgetary stringencies. Innovative use of the private sector via PPP is often canvassed as part of the solution. Whether this is the case depends upon the nature of the budgetary constraints perceived to be preventing conventional public funding. For example, *if* tolling of the PPP infrastructure is feasible, and *if* this does not directly or indirectly reduce public revenues, the potential for 'additionality' can be identified. If, however, the PPP infrastructure cannot be tolled, what happens is time re-profiling of publicly-borne costs from high upfront capital cost plus 'low' running costs to 'moderate' unitary payments to the concessionaire (ie private sector operator of the infrastructure). Governments currently in office may apply very high implicit discount rates to costs occurring beyond their period of office, so the political calculus may diverge from the economic calculus promulgated by official guidance such as the Treasury's Green Book (Treasury 2003).

Second, the argument is often made that the private sector is inherently more efficient than the public sector. In the present public infrastructure context, it is contended that a private sector concessionaire will more efficiently manage the procurement and operation

stages than a public authority. If this were the case, there would be VFM gains from adopting PPP in situations where conventional public funding is available.

One of accounting's most important impacts on government derives from its classificatory function. Determining which 'side of a line' a particular transaction falls can have profound implications for public policy. This impact has intensified with the move of a number of industrialized countries from government accounting on a cash basis to accruals accounting closely linked to private sector regulation and practice. An archetypal case is the treatment of PPP assets.

This paper clarifies the substance of PPP accounting and explores the complex regulatory arena that is influencing its evolution. It does not address the question of whether PPPs constitute 'good' or 'best' VFM, an important topic that is outside its scope. The paper is organized in the following way. Section 2 considers how theories of regulatory space and of competition between regulators may illuminate the processes and substance of PPP accounting. Section 3 examines UK experience with PPP accounting under UK GAAP, where there has been arbitrage between the accounting standard FRS 5A (ASB 1998) and what purported to be interpretation (Treasury Technical Note 1 (Revised)) (Treasury Taskforce 1999). Section 4 moves on to the future context where the United Kingdom will adopt IFRS as the anchor for accruals accounting in government, showing the reasoning behind the UK Treasury's 'projection' of IFRIC 12 (IASB 2006) on to the public sector client. Section 5 examines the international developments through which the International Public Sector Accounting Standards Board (IPSASB) is developing similar ground. Section 6 examines the national accounts treatment of PPP assets and explains the enhanced prominence of national accounts statisticians in the enlarged regulatory arena in which PPP accounting will be settled. Finally, Section 7 views PPP accounting developments through the theoretical lenses of Section 2.

2. Competition for Regulatory Space

Private sector financial reporting and auditing are closely related activities that are conducted in arenas where state and market intersect. Irrespective of how particular institutions and practices are clothed in language, state power is evident and it is often difficult to establish definitively where the private sector ends and the public sector begins. Some of this ambiguity is inevitable given the characteristics of these activities,[1] but some of it is socially constructed in order to mediate complex social and economic forces. Historically these issues have been resolved within each nation state, producing a spectrum from profession-dominated to state-dominated in largely self-contained national systems.

With regard to the United Kingdom, Moran (2003, p. 81) commented that 'The [Accounting Standards Board] has, in effect, acquired a statutory licence to govern financial reporting', being recognized by the Companies Acts. He characterized UK arrangements as

> 'the result of a complex bargain with the state: it offers greatly increased formal organization and more elaborate codes in return for independence from direct statutory control … In this new structure, nobody could possibly work out where the public begins and the private ends' (p. 81).[2]

What used to be recognizable as self-regulation now operates in an arena that is nominally private – such bodies are classified to the private sector in the national accounts – but exercise functions conditionally delegated by the state.

Much economic regulation at the nation-state level has become unsustainable. Pre-existing regulatory compromises have been overturned by a combination of forces: the globalization of economic activity and financial markets; the development of regional economic blocs such as the European Union (EU); and the policy emphasis from the 1980s onwards on the market and on various forms of privatization of government

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[1] Abbott and Snidal (2001, p. 362) cited accounting regulation as an example of 'transactional interconnectivity', that type of standards problems characterized by network externalities and regulatory externalities. Governance arrangements can be public or private and have to address asymmetries and third-party effects.

[2] Moran was referring to a now superseded system, but his conclusion is still apposite to the system in which the Financial Reporting Council operates through subsidiaries which include the ASB, the Auditing Practices Board, the

activity. These trends are evident in the regulation of private sector financial reporting, in which listed enterprises across the world are shifting to US GAAP or IFRS and where these two systems are nervously negotiating about convergence. Many of the tensions affecting financial reporting and auditing developments in the private sector are transmitted to the public sectors of those countries that have switched to accruals accounting.

Hancher and Moran's (1989) metaphor of 'regulatory space' has been applied to many different forms of regulation, including accounting (Young 1994). In discussing the usefulness of the regulatory space metaphor, Scott (2001) attributes part of its popularity to a reaction against characterizations of the regulator-regulatee relationship as one of hierarchical domination. A regulatory arena is 'delineated [regulatory] space' (Hancher and Moran 1989 p. 277), in which a range of regulatory issues may be contested by participants. The distribution across participants of 'resources' – these will include *financial*, *expertise*, *information access* and *enforcement capability* – emerges as a common concern in studies of regulation.

This four-fold classification of 'resources' exercised within regulatory space illuminates developments in PPP accounting. It can be combined with the typology which Walker and Robinson (1994a,b) adapted from Baysinger's (1984) analysis of corporate lobbying, mainly in relation to governments and interest groups that created opportunities or threats. Baysinger (1984, p. 249) differentiated:

- *Domain management*, through which private firms 'gain at the expense of others, especially through government assistance'
- *Domain defence*, whereby private firms 'challenge and rebuff threats to *organization goals and purposes*, including those posed by government' (italics added)

Professional Oversight Board, the Financial Reporting Review Panel and the Accountancy and Actuarial Discipline Board.

- *Domain maintenance*, whereby private firms ‘challenge threats to the *methods* by which organizational goals and purposes are pursued, especially those posed by government’ (italics added)

The notion of ‘domains’ is related to, but different from, that of regulatory arenas. Whereas the latter represents a conceptual mapping by the researcher, the former refers to the perceptions of the actor as to what constitutes their domain. At least in principle, it should be possible to map the domains of actors on to regulatory arenas.

Walker and Robinson (1994a) examined the interactions between the accounting profession, the Australian government and the Australian Securities Commission relating to the promulgation of accounting rules on related party transactions. They concluded that these interactions were consistent with Baysinger’s (1984) domain typology, as they reflected attempts by these organizations to manage, defend or maintain their domains. Walker and Robinson (1994b) adopted a similar approach in their parallel paper on the troubled development of the Australian cash flow reporting standard. In distinguishing the mechanism of agenda entrance, they differentiated between the ‘systematic agenda’ (within the legitimate jurisdiction of a regulatory authority) and the ‘formal agenda’ (under active consideration). Bringing items onto the formal agenda involves the stages of ‘issue creation’, ‘issue expansion’ and ‘agenda entrance’. They analysed agenda entrance in terms of three models: the outside-initiative model; the inside-initiative model; and the mobilization model.

The UK system of private sector accounting regulation gathered substantial maturity after the establishment in 1990 of the Accounting Standards Board (ASB) which, then chaired by David Tweedie, took control of the arena of UK private sector accounting. In 1995, the ASB stood aside from the debate about independent regulation of UK central government accounting which was to move to accruals from 2001-02; the ASB might have bid for a role, but did not. It was established with a specific agenda (if not a ‘mandate’) after a period during which accounting and financial reporting was discredited, eg off-balance sheet financing, goodwill and brands (Tweedie and Whittington 1990). During 1995 the ASB was preoccupied with major issues, such as the

promulgation of standards on goodwill and intangibles, acquisition and mergers, and deferred taxation. It introduced revolutionary changes to UK accounting and financial reporting and it was then facing stiff opposition from the preparers of financial statements.

Furthermore the public sector was seen as being ‘different’. The UK system of accounting regulation which was introduced in 1990 was modelled to a great extent on the US (eg membership and standard-setting process of the ASB and Financial Accounting Standards Board (FASB); and the role of oversight bodies, the Financial Reporting Council and the Financial Accounting Foundation). Given that in the US the Government Accounting Standards Board (GASB) has sole responsibility for setting accounting standards for US states and local governments it would have been seen as an ‘anomaly’ if the ASB assumed the role of setting accounting standards for the public sector. In any case, opening another ‘front’ would probably have been beyond the ASB’s logistical capacity.

The Treasury (1994) originally proposed that it would take responsibility for public sector accounting standards under accruals accounting, a stance that was much criticized. A proposal from the Chartered Institute of Public Finance and Accountancy (CIPFA 1995) was for the creation of a Public Sector Accounting Advisory Board, ‘under the umbrella of the Financial Reporting Council (FRC), as a sister board to the (CIPFA 1997, p. 34). The outcome was the 1996 establishment of the Financial Reporting Advisory Board (FRAB), which would review and approve Treasury deviations[3] from, and public sector interpretations of, UK GAAP. However, the ASB did retain a role in relation to the negative assurance franking of Statements of Recommended Accounting Practice, including that for local authorities (which accounted for 27% of UK public expenditure in 2007-08) (Treasury 2008b, Table 1.15). Subsequently, the ASB’s development of an interpretation of its (private sector) *Statement of Principles* (1999) for Public-Benefit Entities (2003, 2005 and 2007) might be seen as staking out ground in the context of the

[3] The official terminology is ‘adaptations’; FRAB’s annual reports list those adaptations and interpretations that it has approved.

upward movement of private sector accounting regulation to the International Accounting Standards Board (IASB).[4]

When the anchor for UK central government accounting moves from UK GAAP to IFRS in 2009-10, this domestic arena of accounting regulation will be subordinated to the international arena. Indeed, preparations for the switchover are already well-advanced. Instead of enjoying a dominating role, the ASB is only one of many national regulators seeking to influence the direction of the IASB (currently chaired by Sir David Tweedie), including convergence proposals with US GAAP.

This migration of accounting regulation 'upwards' might have led to the Treasury proposing and the FRAB approving more deviations/interpretations from IFRS for public sector use, but this has not happened. Four factors seem to explain this: the differences between UK GAAP and IFRS have been narrowing; the relative influence of competing interests within the Treasury is now different from that in the late 1990s; the FRAB has developed an operating philosophy that avoids deviations unless there are compelling public/private *accounting* differences; and the epistemic community revolving around financial reporting is embedded at various locations in the regulatory arena, with many participants holding 'cumulative mandates'.[5] Section 4 examines how PPPs will be accounted for when IFRS becomes the anchor for UK central government accounting in 2009-10.

Less expected has been the emergence of the International Public Sector Accounting Standards Board (IPSASB)[6] which has developed its own views on those deviations from/interpretations of IFRS that are required for public sector accounting. Section 5

[4] Statements of Principles might seem to have greater force than Standards and Interpretations, though that is not the UK case. Conceptually, (Statements of) Principles should precede standards, but in practice lag.
[5] This is a translation of 'le cumul des mandats', an important characteristic of French politics: the same individual may be, for example, mayor of a town, President of a Regional Council and a member of the Senate.
[6] IPSASB is a body which is growing in importance. For example, GASB is collaborating with IPSASB on asset impairment and the two bodies are considering the possibility of collaborating on issues related to fiscal sustainability and conceptual frameworks (Attmore et al 2008).

below examines the proposals for PPP accounting made in an IPSASB (2008) Discussion Paper which is currently out for consultation.

'Always there but now taking a more prominent role' would be a useful description of how the epistemic community of national accounts statisticians has emerged as participants on the particular issue of PPP accounting. There are identifiable reasons – eg increased international surveillance of macroeconomic and fiscal policies – why national accounts statisticians figure prominently in debates about the financial reporting of PPP schemes. Their perspectives are addressed in Section 6 below.

It is possible to construct two images of an optimally designed regulatory system. At one end of the spectrum, there is a single regulator with wide-ranging and effective powers. Regulation can then be rational, uniform and tidy. Hitherto, national systems of private sector accounting regulation would be abolished, or at least subordinated to a global system led by the IASB. An extension of this for public sector accounting would be for the IPSASB to determine deviations from/interpretations of IFRS for use by governments in all countries. Such arrangements, if operationally effective, would improve comparability of private sector financial statements and of governments' fiscal positions.

Those favouring uniform standards, which increasingly mean global standards, typically use two arguments. First, these are necessary to promote comparability and hence transparency. Second, multiple standards will lead to opportunistic arbitrage between standards, which may lead to a 'race to the bottom' (note Gresham's Law) in terms of what standards require. 'Venue shopping' in legal disputes relates to fighting cases in the jurisdiction yielding the highest expected 'reward'. There is nothing new in such regulatory arbitrage[7] except that the practice has spread into professional domains such as law and accounting. Research on the processes of the European Union emphasizes the way in which interest groups exploit opportunities for venue shopping (Mazey and Richardson, 2006).

At the other end of the spectrum is the case for competition between regulators, advanced for many of the same reasons that competition is portrayed as desirable in the market economy. The ability of firms and governments to choose between regulators would discipline regulators to be efficient and might increase the transparency of the system. In terms of economic regulation more generally, Laffont and Martimort (1999) advocate competition between regulators: instead of merging regulators with different functional remits, keep them separate and learn from the competition between them. Regarding private sector accounting regulation, Dye and Sunder (2001) discuss a number of advantages and disadvantages relating to the introduction of competition in accounting standard-setting. Among the advantages claimed are greater efficiency, the protection of standard-setters from lobbying by interest groups, and the possibility of developing different standards for different clienteles.

The argument for competition rather than merger might also be applied to the tensions between financial reporting and national accounts; that is an issue for Section 6.

3. Client Accounting for PPP Assets under UK GAAP

In the 20 years since landmark announcements by the then UK Conservative Government, PPPs have become a significant procurement mechanism. Instead of procuring capital assets, governments contract with the private sector for the provision of specified services. Over this period there has been ample time and opportunity to resolve conceptual and technical issues of how public sector client accounting should be done.

In the United Kingdom, the Treasury established the FRAB in 1996 in order to inject an 'independent element' into accounting regulation for the switch by UK central government from cash to accruals with effect from 2001-02. The FRAB, subsequently put on a statutory basis by the *Government Resources and Accounts Act 2000*, has frequently drawn attention to the unsatisfactory condition of PPP accounting. In the FRAB's First Report (FRAB 1997, para 2.11.1), it noted with regard to the draft Financial Reporting Manual:

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[7] A long-standing commercial example is the flags of convenience which are used by shipping companies.

> The application of GAAP to PFI projects is a complex subject. Detailed guidance is being developed by the Public Sector and Not-for-Profit Committee of the Accounting Standards Board.[8] We accept that, for the time being, the Manual can only give a broad indication of the accounting treatment, but will return to this when detailed guidance is available.

In its Tenth Report, the FRAB (2007c, Executive Summary, para 6) noted:

> A particular area of interest that has been the concern of the Board for a long time is accounting for transactions financed by the Private Finance Initiative (PFI). The Board has expressed its concern over the level of inconsistency in accounting for PFI across different parts of the public sector, although there is some consistency within sectors.

The main purpose of this section of the paper is to clarify why the FRAB's well-founded concerns about PPP accounting were never satisfactorily resolved in that ten-year period. It will become clear that the obstacles were not inherently technical, but were either accidental or intentionally constructed.

The most convenient place to start is to examine the latest available information on how PPP assets are currently accounted for under UK GAAP. Table 1 provides an analysis of PPP schemes by government department: this includes both a department's own PPP schemes and those of public sector organizations for which it is responsible. This Table shows that 13% of schemes by number are on the public sector balance sheet whereas 87% are off. However, in terms of value, the picture is quite different: 43% On and 57% Off. Table 1 shows that this divergence is a result of Transport having 40% of the total value and a ratio of 88% On: 12% Off. The possibility that these variations are solely attributable to the objective characteristics of the particular schemes within departmental spheres of responsibility will be rejected below.

In summarized form, the chronology of accounting regulation for PPP (Hodges and Mellett 2002, 2005) between the first (1997) and tenth (2007) FRAB reports ran as follows:

- In September 1997, Treasury Taskforce published Technical Note 1 in the context of a perceived absence of guidance in UK GAAP as to how the public sector client should account for PPP assets

[8] This is a reference to the development of what would become FRS 5A (ASB 1998).

- The ASB, which had published FRS 5 (ASB 1995), its 'substance over form' standard, published FRS 5A (ASB 1998) in September 1998, the Exposure Draft having been published in December 1997. This related specifically to PPP accounting, being motivated by a desire to avoid 'bad' practices that the ASB believed it had purged in the private sector returning via public sector practice
- In June 1999 a revised version of the Treasury's 1997 guidance on PPP accounting was published as *How to Account for PFI Transactions: Technical Note 1 (Revised)* (Treasury Taskforce 1999). The FRAB insisted on 'retrospection', in the sense that PPPs in place or in progress would be accounted for under the revised guidance[9]
- 2001-02 was the first year on which UK central government accounted on an accruals basis, therefore being the first year when the controversies between the ASB and Treasury over PPP accounting had operational impact
- After years of widespread criticism about perceived inadequacies and inconsistencies in PPP accounting, in March 2006 the Treasury set up a PFI Working Group; this had membership from Treasury, the Audit Commission, the National Audit Office and large professional firms
- In February 2007, the Working Group reported in favour of withdrawing Technical Note 1 (Revised) and the FRAB declared itself 'minded to recommend' withdrawal but did not make a recommendation to the Treasury so as to allow the Treasury more time in which to assess the budgetary implications
- In the 21 March 2007 Budget, the Chancellor of the Exchequer announced that the United Kingdom would move its government accounting from UK GAAP to IFRS, with effect from 2008-09. The practical effect of this announcement was

[9] In the National Health Service, this change of guidance affected a group of early PPP-funded hospitals, including the Edinburgh Royal Infirmary and seven hospitals in England. These were off-balance sheet and came on balance sheet because the payment mechanism was not judged to transfer sufficient risk to the private sector under the revised Technical Note. In public expenditure terms, the Treasury dealt with these cases by means of classification changes, increasing the allocations so that changes in accounting regulation did not penalize arrangements entered into in good faith.

that both FRS 5A[10] and Technical Note 1 (Revised) would be irrelevant after 2007-08

- In the 12 March 2008 Budget, the Chancellor of the Exchequer announced that the switch to IFRS would be postponed until 2009-10. Members of the FRAB giving evidence to the Treasury Committee (2008a) of the House of Commons indicated that the original timetable had been too tight to accommodate the workload involved for certain departments (Defence and Health being mentioned) and in relation to the funding timetable for NHS bodies.

The effect of this chronology is that, throughout the 2001-02 to 2008-09 period of accruals accounting with UK GAAP as the anchor, there has been a tension between FRS 5A and Technical Note 1 (Revised). Formally, the former is a standard whereas the latter is an interpretation, intended to assist public sector bodies with unfamiliar accounting transactions. In practice, they came to be viewed as competitor standards, creating the opportunity for arbitrage between them. An extensive consultancy business developed for accountancy firms to give advice in advance as to whether potential PFI projects would be On or Off balance sheet.

Although never documented in the public domain, it became part of the common knowledge of participants in the PFI procurement process that PricewaterhouseCoopers and KPMG were more likely to pronounce a project Off than were Deloitte and Ernst & Young. The National Audit Office became known to be more insistent on On treatment than the appointed auditors of the Audit Commission. The former, headed by the Comptroller and Auditor General who is an Officer of Parliament, has more capacity to dispute treatments with the Treasury. In contrast, the latter were constrained by the Government's control framework over the National Health Service and local authorities which directly linked funding/permissions to off-balance sheet treatment. Moreover, the Audit Commission itself could not instruct its appointed auditors which included private firms.

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[10] One of the reasons for the issuing of FRS 5A was that the leasing standard SSAP 21 (ASC 1984) remains vulnerable to manipulation, particularly with regard to its 90% rule, and the innovative growth of PPP activity would

On a technical level, UK GAAP approaches the question as to whether a particular asset should be on the balance sheet of an entity not in terms of ownership but of which party bears the majority of the risks and rewards. Intuitively one would expect that particular PFI schemes would fall into either the top-left (On:Off) or bottom-right (Off:On) quadrants of Figure 1. This means that both the On:On and Off:Off quadrants would be empty: the former entails double counting and the latter entails omitted assets. In practice, however, different judgements might be made by the finance directors and auditors on the operator and client side, on the basis of the evidence available to them, thus leading some marginal cases to fall into these otherwise empty quadrants. Unlike the national accounts (see Section 6) the financial reports of independent reporting entities do not articulate.

Extensive Off-Off treatment illustrates the potential for arbitrage that has existed between FRS 5A and Treasury Technical Note 1 (Revised). Hodges and Mellett (2002, 2005) examined how the ASB came to produce FRS 5A and how the Treasury subsequently revised Treasury Technical Note 1 (Treasury Taskforce 1997). There were two main areas of dispute. The first related to the separability of the unitary payment under PFI contracts between a facility element and a service element. On this, the ASB largely held its ground, though modifying its tests for separability (Hodges and Mellett 2002, p. 145). The second related to construction risks that the ASB held to be irrelevant to the judgement of which party is bearing the majority of the risks and rewards of asset ownership. On this, the ASB held its ground. However, the wording of Treasury Technical Note 1 (Revised), to which the ASB eventually assented, created opportunities for arbitrage. Future PFI contracts would be written in such a way as to satisfy Off-balance sheet treatment on Technical Note 1 (Revised) even if they would not have satisfied FRS 5A. Moreover, Heald (2003) demonstrated how the FRS 5A irrelevance of construction risk to balance sheet treatment might be circumvented by blurring the distinction between construction risk and design risk when undertaking the quantitative analysis promoted by Treasury Technical Note 1 (Revised).

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otherwise have new opportunities for manipulation.

Throughout this period, the Treasury has denied the objective of keeping assets off the public sector balance sheet (eg Treasury 2006). However, as both media coverage and academic commentary (Broadbent and Laughlin 2002, Froud 2003, Rutherford 2003) have observed, the credibility of this public position has been undermined by the widespread understanding that the PPP was often the ‘only show in town’ and that, otherwise, there would be no new assets. The Comptroller and Auditor General has criticised government departments for providing web guidance that on-balance sheet PPP would not be funded; such statements might have been unwise but certainly reflected practical reality. In the critical period 1997 to 1999, the issue of PPP balance sheet treatment by the public sector mattered more to the Treasury than it did to the ASB. This was a very tight period of public expenditure control and the issue of accounting treatment was portrayed as irrationally holding up much-needed public capital investment.

This narrative and analysis of client accounting under UK GAAP is distinctively British in its orientation: the key actors were the Treasury and its offshoot Treasury Taskforce; the FRAB (appointed by the Treasury); and the ASB (the UK private sector accounting regulator). Only latterly did the Office for National Statistics (ONS) become actively involved. The anchor for accruals accounting in government (known as Resource Accounting) was UK GAAP, of which the ASB is the guardian. The ASB’s role in government accounting was therefore indirect but important: it set the anchor from which the FRAB needed strong arguments to diverge; and its Public Sector and Non-Profit Committee (now the Committee on Accounting for Public-Benefit Entities) controlled the process through which the ASB gave negative assurance to the Statements of Recommended Accounting Practice (SORPs) that regulated accounting in certain important sectors (eg local government, universities and charities). However, the ASB’s attempt to regulate PFI accounting via FRS 5A failed because of the arbitrage opportunities created by the co-existence of FRS 5A with Treasury Technical Note 1 (Revised).

In central government, the National Audit Office's insistence on FRS 5A brought many PFIs on balance sheet, notwithstanding that the Technical Note had been devised for central government. Elsewhere, the public expenditure control framework set by the Treasury and implemented by government departments over entities within their functional remit led to Technical Note 1 (Revised) trumping FRS 5A. Hodges and Mellett (2002, p. 147) concluded that the ASB and the Treasury both prevailed on the dimensions most important to them: the ASB in terms of asserting its regulatory authority over the private sector; and the Treasury in facilitating the rapid expansion of capital expenditure via PPP schemes.

In March 2006, the Treasury established the PFI Technical Working Group at the request of the FRAB to discuss the possible amendment or withdrawal of Technical Note 1 (Revised). Later, 'At the FRAB meeting on 29 June 2006, the working group was asked to proceed on the basis that the FRAB will recommend to HM Treasury that the TN be withdrawn' (FRAB 2007a, p. 2). The final report of the Working Group was presented to the FRAB on 12 February 2007, when 'FRAB concluded that it is minded at its next meeting to advise HM Treasury to withdraw its Technical Note, subject to a further presentation and package of proposals from HM Treasury' (FRAB 2007b, para 18). The first year to be affected would have been 2008-09 but the prospective recommendation was overtaken by the 21 March 2007 Budget announcement of 2008-09 as the year in which IFRS would be adopted.

The key to understanding why deficiencies in PPP accounting under UK GAAP were not addressed is that participants in the UK regulatory arena had no 'enforcement capability' (Hancher and Moran 1989, Scott 2001) over public sector accounting,[11] other than the Treasury, which was itself the main architect of the problem. Of Hancher and Moran's (1989) four resources that are drawn upon by participants in regulatory space, inequalities in *information access* combined with the absence of *enforcement capability* outside the Treasury. Whereas UK GAAP is described as being principles-based, there was pressure

[11] In the private sector, the Financial Reporting Review Panel, one of the Financial Reporting Council's operating bodies, can ask for accounts to be corrected.

for detailed rules on PPP accounting. Two distinct motivations can be discerned: rules are easier to circumvent; and individual local authorities and NHS Trusts with 'once-in-a-lifetime' PPP schemes genuinely felt in need of guidance that told them how to account.

4. Client Accounting for PPP Assets under IFRS (UK Arena)

Domestic regulation of government accounting was disturbed by the move of EU-listed companies to EU-adopted IFRS for financial periods beginning on or after 1 January 2005. Resource Accounting had been established on the premise of using best private-sector practice, modified as necessary to suit the special circumstances of the public sector.[12] This switch of EU-listed companies to IFRS changed what constituted private sector best practice; in time UK GAAP, the public sector's anchor since 2001-02, would either converge on IFRS or wither away. Accordingly, the question became when, not whether, UK government accounting would switch to being IFRS-based. The Treasury and the FRAB made extensive preparations in the form of developing a draft I-FREM, the IFRS counterpart to the UK GAAP-based Financial Reporting Manual. This conversion acquired a timeline with the Treasury's March 2007 announcement of IFRS conversion for 2008-09, later rescheduled to 2009-10. Issues relating to PPP accounting under IFRS were the decisive factor behind this delay, though there had also been an underestimate of the amount of work involved in the changeover.

The prospective switch to IFRS nullified the impending recommendation of the FRAB that PPP accounting would be improved by the Treasury withdrawing Technical Note 1 (Revised) with effect from 2008-09, leaving the field to FRS 5A. The new problem was the absence of guidance in IFRS as to how PPP assets should be accounted for by the public sector client. All that IFRS contained was IFRIC 12, an Interpretation not a standard, and this was directed exclusively to the private sector operator of PPP contracts.

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[12] The *Government Resources and Accounts Act 2000* contained the provision that, when exercising the power to issue directions '… the Treasury shall in particular –

(a) have regard to any relevant guidance issued by the Accounting Standards Board Limited or any other body prescribed for the purposes of section 256 of the Companies Act 1985 (accounting standards)'.

The Companies Act (International Accounting Standards and Other Accounting Amendments) Regulations 2004 contains provisions that permits the transition of government accounts to IFRS.

How this vacuum would be filled became an important issue in the approach to 2008-09, the original IFRS implementation date for UK central government. With nothing in IFRSs or IASs, attention settled on whether IFRIC 12 could be 'extended' to provide the necessary guidance. As well as the technical dimension to this question, there is a much broader authority and legitimacy question.

Figure 2 shows the final version of the diagram developed by the Treasury to explain accounting treatment of PPP assets under what has become known as the 'mirror image of IFRIC 12'. For expositional convenience, the columns on the flow chart are labelled as Columns 1 to 3. For the mirror-image treatment under IFRIC 12 to apply, there must be 'Yes' answers to each of three questions:

- The first question relates to control by the grantor (ie public sector client) over the use of the infrastructure and the pricing of the services it provides
- The second question relates to the public sector client having control over the residual interest in the infrastructure after the end of the concession period
- The third question relates to whether the infrastructure is acquired from a third-party or was previously recognized as an asset by the operator

With affirmative answers to each, the accounting treatment is to separate the unitary charge between property, interest and service elements, and to report the property element as an asset and related liability and to recognize the interest and service expenditure as they fall due. Column 1 of Figure 2 details this mirror-image treatment. Following IFRIC 12, the private sector operator does not account for concession assets as property, plant and equipment on its balance sheet, whereas the public sector client does.

Column 2 deals with two cases. The first is where the arrangement contains a lease (IFRIC 4) (IASB 2004), in which case the public sector client recognizes the lease on its balance sheet in accordance with IAS 17 (IASB 2003c). The second is where the operator is given access by the grantor to owned or leased assets, in which case these stay on the latter's balance sheet. Column 3 then covers the case where there is neither a concession (IFRIC 12 does not apply) nor a lease (IFRIC 4 does not apply); the grantor then recognizes expenditure as it falls due.

The globalization of private sector financial reporting, or at least the creation of two blocks adhering to US GAAP or IFRS, complicates UK public sector accounting. First, given the commitment to follow private sector best practice, public sector accounting must in time move as well. Second, the lack of interest in public sector accounting displayed by international regulators creates problems for countries with commitments to (largely) sector-neutral accounting. A telling illustration is how the IASB/FASB joint work towards a shared Conceptual Framework has ignored the public sector procedurally by relegating consideration to late in the development process and substantively by downgrading stewardship.[13]

The practical issue faced by the Treasury was how to fill the gap in IFRS about client accounting for PPPs that under UK GAAP ought to have been filled by FRS 5A. This has been done by two kinds of 'stretching'. First, IFRIC 12, designed solely for the private sector operator, has been extended by creating the 'IFRIC mirror-image treatment'. The fact that the private sector operator will not generally account on-balance sheet for the property therefore indicates that the public sector should do so.

Second, the term 'infrastructure' has stretched far beyond the 'underlying fabric' of Diamond's (1990, p. 77) definition as 'the diverse collection of public assets that underpins the economy – however provided and managed'. A vast range of assets now falls within PPP schemes, for example, prisons, schools, hospitals, student residences and administrative blocks. Roads fit into the traditional notion of infrastructure that stresses the network dimension. Infrastructure now seems to mean any asset that can be made the subject of a concession arrangement.

This extension of IFRIC 12 and the stretching of the term 'infrastructure' have, at least temporarily, provided a basis on which the important topic of PPP accounting will be dealt with by the UK public sector from IFRS implementation in 2009-10. However,

certain aspects require attention. First, IFRIC 12 uses the criterion of 'control' rather than that of 'bearing the majority of risks and rewards of ownership' used by both FRS 5A and the Treasury Technical Note 1 (Revised). The 'risks and rewards' accounting criterion was aligned with the notion that risk transfer is the central driver through which the public sector will gain efficiency benefits from using PPPs. The switch to IFRS will create a decoupling. A difficult question to answer is to what extent the public sector client's on-balance sheet decision would actually differ between 'risks and rewards' (FRS 5A version) and 'control' (mirror image of IFRIC 12). 'Control' in the private sector is more clear-cut than 'control' in the public sector, the ambiguities of which have generated a huge literature in political science (eg Kaufmann et al (eds) 1986).

A driving factor behind these developments was the search for 'symmetry' in the accounting treatment of public sector client and private sector operator. Extensive Off-Off treatment throughout the 1990s had been a manifestation of accounting regulation problems that could be communicated to a wider public, including Members of Parliament, the media and informed public opinion. Whilst exceptional cases of Off:Off might have been legitimate, its extent became interpreted as evidence that the control framework had distorted accounting. Symmetry may in practice still not be achieved. First, most PPPs in the United Kingdom are managed via unlisted Special Purpose Vehicles (SPV). Whereas a listed company undertaking/consolidating PPP schemes is required to apply IFRIC 12, the SPVs might continue to account under UK GAAP, applying FRS 5A.

Second, under UK GAAP, some early PPPs had the underlying asset on balance sheet. This was overtaken by a trend to undertake financial asset accounting as it results in accelerated profit recognition compared with fixed asset accounting. Although the same incentive may apply under IFRIC 12, there remains the unco-ordinated nature of the decisions of grantor and operator. Third, the public sector's knowledge of accounting treatments adopted by private sector operators may remain poor; even the National Audit

[13] The lack of priority attached to ensuring that the revised Conceptual Framework is appropriate for public sectors in countries where IFRS is applied may in part be attributable to the institutional structure in the United States,

Office experienced difficulty assembling necessary information on schemes to compare treatments. Fourth, implementation might encounter difficulties, particularly in relation to PPPs that do not fit into the IFRIC 12 model: neither the Treasury nor the FRAB were in a frame of mind to change tack when 'consultation' demonstrated strong opposition from some spending departments with extensive PPPs. The relationship between the control-based IFRIC 12 and the risk and rewards-based IFRIC 4 and IAS 17 (see Figure 2) may cause future problems.

The Treasury and the FRAB combined to adapt IFRIC 12 to prescribe public sector accounting treatment under IFRS from 2008-09. The FRAB's annual reports – as quoted in Section 3 – had repeatedly expressed dissatisfaction with PPP accounting. Clearly the change came from the Treasury, probably reflecting both contextual changes in the spending climate and a different weighting between competing interests in the Treasury itself. On listening to an exposition of the PFI by the Conservative Financial Secretary (Stephen Dorrell MP) in 1993, the Conservative MP Nicholas Budgen commented:

> … the construction industry is in a truly dreadful state and you have got to think of some ways in which it can be resuscitated and to think of some more or less respectable argument for providing them with what may be rather more expensive finance … the irony is that by the time you have finally worked out both the principles and practice of this system of private financing it is highly likely that the cycle of economic activity will have changed and once again you will have to think of some apparently important principle which will then make it more difficult for private finance because you will be told by those who manage the economy that this type of financing is inappropriate in circumstances of some strength of the economy (Budgen 1993, Questions 8.9).

In 1993 and again in the late 1990s, the Governments of the day wished to develop the PPP as a procurement mechanism. The dominant set of interests within the Treasury in the early 1990s may have related to the struggling macroeconomy. In the late 1990s, particularly after the change of government from Conservative to Labour in 1997, those promoting the use of PPPs to supplement public investment rapidly acquired great influence, operating through a series of quasi-independent units within the Treasury. Notwithstanding Labour's criticism of PPPs whilst in opposition, these developments were driven by ministers. Accounting, which had little prestige in the Treasury until the

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where the Government Accounting Standards Board has responsibility for state and local government accounting.

1994 appointment of Andrew Likierman as Head of the Government Accountancy Service, had limited influence on matters as close to ministerial policy. Approaching the end of the first decade of the 2000s, the policy context had changed dramatically: after years of unprecedented rates of public expenditure growth, the UK fiscal position was sharply deteriorating. Instead of heavy promotion of PPPs, the Treasury interest favoured at least greater transparency. Moreover, the National Audit Office persistence had led to the position in Table 1 whereby 43% of PPP by value was already on the public sector balance sheet. The Treasury's domain management and maintenance needs had changed.

The Treasury as a whole has not fully appreciated that claiming prestige from using private sector accounting standards as the anchor for government accounting might sometimes bring unwanted 'news'. A fundamental difference between public and private sectors is that budgeting at all tiers of government, and funding flows between them, is intimately connected with accounting treatments. This 'join' between accounting and budgeting requires careful management and advance planning. Other factors, regarding national accounts and fiscal surveillance, had mounted in importance: these are considered in Section 6 after a brief discussion in Section 5 of PPP accounting developments on the global arena.

5. Client Accounting for PPP Assets under IFRS (Global Arena)

The International Federation of Accountants (IFAC) established in 1986 its Public Sector Committee, being renamed the IPSASB in 2004. The Standards Project commenced in 1996. In the early years this self-constituted body could be safely ignored by governments moving to accruals accounting by means of anchoring themselves to full (New Zealand) or modified (United Kingdom) 'local' GAAP, with the subsequent logic favouring full or modified IFRS. As the IPSASB acquired momentum – there are still issues regarding its future funding – the potential for tension arose between 'straight to IFRS' countries and those countries adhering to IPSASB-modified IFRS. In the past there has been a substantial lag between the publication of IPSASs in relation to IASB standards (Sutcliffe 2003), but that gap is closing.

Whereas the conditional delegation of public functions by an individual state can be understood (Moran 2003), the legitimacy question is more problematic in the global arena. The private status of the IFAC (a federation of accountancy institutes) and thus of the IPSASB creates uncertainty about the legitimacy and authority of IPSASB pronouncements. However the fact that its work has been promoted and partly funded by the International Monetary Fund and the World Bank is significant in terms of the future potential influence of IPSASs.

When the UK Treasury and the FRAB were developing the UK approach to PPP accounting under IFRS, it was known that the IPSASB was engaging on a much larger project intended in due course to be promulgated as an IPSAS. However, the timescale of 2008-09 (originally 2007-08) implementation meant that the United Kingdom could not wait. In March 2008, the IPSASB (2008) published a consultation paper on public sector client accounting for service concession arrangements, with the consultation period closing on 1 August 2008. This document covers more issues than does the Treasury (2008c) guidance, particularly with regard to the accounting when the PPP does not meet the proposed criteria for a service concession agreement. Some individuals who had been involved in the UK developments were also participants in these international discussions.

The IPSASB approached the matter from a similar direction to the Treasury, and proposes to extend IFRIC 12 to the public sector client by adopting mirror-image treatment. Its approach is summarised in two flow charts: Flowchart 1 (IPSASB 2008, p. 69) shows how to establish whether there is a service concession arrangement. This depends upon whether the service concession agreement meets two criteria:

1. The grantor controls or regulates what services the operator must provide with the underlying property, to whom it must provide them, and the price ranges or rates that can be charged for services; and
2. The grantor controls – through ownership, beneficial entitlement or otherwise – the residual interest in the property at the end of the arrangement (IPSASB 2008, para 102).

When both control criteria are met, the grantor 'Reports the property as an asset and reports a related liability reflecting any obligation to provide compensation (cash or non-cash) to the operator for the property' (p. 69). Flowchart 2 (p. 70) provides for when only

24

one of the two control criteria is met. The most significant difference between the UK and IPSASB treatments relates to the timing of recognition (IPSASB being earlier) owing to different assumptions about whether the grantor or the operator bears construction risk: the UK assumption is that PPPs transfer construction risk to the operator so that recognition takes place at commissioning date.

6. National Accounts Treatment of PPP Assets

It might seem that the similarity of UK and IPSASB approaches to PPP client accounting mark the denouement of a protracted story: the decisions to extend IFRIC 12 to the client side denote a landmark. However, a new basis that may in future permit arbitrage arises from the relationship between financial reporting and the national accounts. The detailed record-keeping that underpins financial reporting can sit uncomfortably with the statistical estimation that forms part of the derivation of national accounts (Jones 2003). The educational and work experience backgrounds of financial reporting standard-setters and national accounts statisticians are entirely different and they have constituted distinct epistemic communities with very little overlap.

Laughlin and Pallot (1998) noted the role that the epistemic community around public sector accounting has played in the international diffusion of change, for example to accruals accounting. However, this does not have the level of systematic organization characteristic of national income accounting; those professionally involved are mostly civil servants working for national statistical institutes. Another significant difference relates to the periodicity of standards revision. Financial reporting standards evolve through time on an unstructured basis, in part responding to medium-term agendas but also to particular crises (eg the introduction of cash flow statements in various countries in the late 1980s and early 1990s). In contrast, there are long periods between full revisions of the 'rule books' for national accounts: the System of National Accounts (SNA) was last revised in 1993 and the derivative European System of Accounts (ESA) in 1995. Previous editions were in 1968 and 1978, respectively. The approval process involves agreement by governments and there is not the same capacity to impose on reluctant preparers that is exercised by the IASB .

Globalization is one of the factors that makes national accounts statisticians take more interest in financial reporting: economies integrated into the global economy have become more difficult to measure and the information contained in entity-level financial reports has become more important. A particular example concerns depreciation, where the national accounts still use perpetual inventory models as the basis for measures of capital consumption.

Moreover, growing internationa1 fiscal surveillance that has accompanied globalization of real economies and financial markets has brought to the fore the national accounts treatment of particular items. National accounts data are used for international surveillance, by the International Monetary Fund (IMF), the World Bank and the Organisation for Economic Co-operation and Development (OECD). This kind of surveillance comes in different shades: for industrialized countries, OECD economic surveys and IMF Article 4 consultations can generate domestic political embarrassment; but for countries dependent on official funding flows there is more bite. One of the contexts in which surveillance undoubtedly has become important is the European Union, where national accounts data are used by the European Commission for Ecofin's monitoring of eurozone countries and of non-eurozone member states, and is also relevant to candidates for either eurozone or EU membership (Savage 2005).

Eurostat, the statistical office of the European Communities, issued in 2006 its own guidance on recording PPPs in the national accounts (Eurostat 2006): this is given force by the way the resulting data are used for purposes of fiscal monitoring under the EU Stability and Growth Pact. The possibilities of disguising government expenditure and commitments was one factor, as was the realization that there had developed a pattern of Off:Off accounting in financial reporting. Such a practice is fundamentally unacceptable in national accounts, because the accounts of sectors articulate; On:On is also unacceptable but believed to be much less common. These circumstances prompted the Office for National Statistics (ONS) to commit resources to investigating the treatment of individual PFI schemes by public sector client and private sector operator (Chesson and

Maitland-Smith 2006).[14] Pressure from Eurostat may have been a factor in pushing this up the ONS's agenda, with the knock-on effect that the Treasury felt more pressure to deal with the financial reporting dimension.

Although financial reporting and national accounts are moving in the same direction (ie more recognition of PPP assets on the public sector balance sheet), there are three important points to note. First, whereas both FRS 5A and Eurostat's rules adopt the risk and rewards approach, there will be a decoupling of financial reporting and national accounts' approaches under both UK and IPSASB versions of IFRS. Second, the Eurostat version of 'risks and rewards' is more likely to allow scoring outside public sector debt than either FRS 5A or Treasury Technical Note 1 (Revised). The only risks considered for the Eurostat assessment are construction and availability risks. Third, the ONS has indicated its view that extension of the control-based IFRIC 12 is not consistent with the Eurostat rules that feed into the United Kingdom's obligations under the Stability and Growth Pact. This raises the possibility that, from 2009-10, each public sector client would have additionally to report to the ONS whether their PFI would be off-balance sheet on the Eurostat basis. The ONS itself is not resourced to examine each scheme. The Treasury responded to Treasury Committee (2008b) recommendations linking the change of PFI under IFRS to the sustainable investment rule (the second of the Government's two fiscal rules):

> 7. [Committee recommendation] **It seems highly likely that, following the move to International Financial Reporting Standards for central government, the sustainable investment rule as currently defined and interpreted will be breached in 2009-10 as a result of the reclassification of PFI projects. As such, the delay announced in Budget 2008 in the implementation of International Financial Reporting Standards gives the Government a chance to announce in advance whether and how it proposes to revise the sustainable investment rule in the light of the implementation of International Financial Reporting Standards. We recommend that the Government publish in the 2008 Pre-Budget Report any proposed changes to the sustainable investment rule and its interpretation arising from classification changes resulting from International Financial Reporting Standards.**

[14] 'On 20 September 2006, the public sector finances First Release included for the first time estimates of imputed finance lease liabilities. The majority of these are associated with those Private Finance Initiative (PF) projects judged as being on the public sector balance sheet (not all contracts under PFI projects involve finance leases) … The estimate of imputed finance lease liability at the end of March 2006 is £4.95 billion' (Chesson and Maitland-Smith, 2006, p. 27).

> [Treasury reply] The Government notes the recommendation of the Committee. There remain significant uncertainties around the impact of the introduction of IFRS on public sector net debt. As 2009-10 will be the first year that IFRS will be applied, the implications of any new standard for individual deals will need to be worked through, and this will also take time. Also, it is the independent Office for National Statistics (ONS) that decides on what is inside the public sector boundary for public sector net debt. The ONS have said that the IFRS approach to PFI is not conceptually consistent with ESA95, which are the standards for the National Accounts used to calculate fiscal aggregates, introducing further uncertainty (Treasury 2008d, pp. 4-5)

This does not sound like the end of the PPP accounting story!

7. Contested Regulatory Arenas

Hood (1994) differentiated between 'justifications' for public policy (ie the reasons that governments give for the adoption of particular policies) and 'explanations' (ie the assessments reached by academic researchers as to what factors contributed to the adoption of that policy). Justifications and explanations overlap but they are usually not identical. This distinction is important background to the discussion of PPP accounting regulation, even in this paper which does not address VFM. Governments now promote PPPs as a means of securing better VFM. In contrast, opponents of PPPs deny VFM gains and portray PPPs as an expensive form of disguised government borrowing. Such debates now take place across the world, not least in fiscally-constrained new EU member states in Central and Eastern Europe (Schwartz 2007, Kiss 2007).

This paper concludes with three provisional conclusions about the evolving story of PPP accounting. First, within 10 years (1997-99 to 2007-08) the regulatory arena has internationalized. In the earlier period, the debates were primarily British, in part because of the size of the PPP developments which were then taking place ahead of those in other countries. The principal actors were the ASB, the Treasury, the National Audit Office and the FRAB, which had been established in 1996 as an advisory board but without a statutory base. In the typology of Baysinger (1984), the ASB engaged in domain defence, in order to protect its role in private sector accounting regulation. In successive annual reports the FRAB made clear its dissatisfaction. The four regulatory resources – financial, expertise, information access and enforcement capability – were very unequally distributed. Only the ASB had the expertise resources to challenge the Treasury, though

the role at this time of the National Audit Office, which would audit the resource accounts, does not seem to have been publicly documented. During this period, the Treasury was engaged in domain defence at the same time that it was committing to private sector accounting standards and accepting an 'independent element' in public sector accounting regulation. There are various 'interests' within the Treasury,[15] the relative influence of which may change through time. Those promoting resource accounting within the Treasury may have faced opposition from other sections of the Treasury to the commitment to private sector accounting standards; this would have raised the significance of PPP balance sheet treatment.

In the later period, there is a multi-level regulatory arena: the dominant international level (the IASB and possibly, in due course, the IPSASB); and the subordinate domestic level (the ASB, the Treasury and the FRAB). In terms of financial reporting, this shift upwards is inevitable if the UK Government is to maintain its commitment to follow best private-sector practice. It might be argued that application of FRS 5A, unencumbered by Treasury Technical Note 1, would have satisfactorily resolved the UK's PPP accounting problems. However, with there being commitment to IFRS conversion, recourse had to be made to IFRIC 12. At a future date the Treasury and the FRAB will have to decide how to react to an IPSASB standard on service concession accounting. In this context, the distribution of the four regulatory resources has been much less unequal: the FRAB lacks its own resources but compensates through access to Treasury staff and the expertise of its members; expertise on PPP accounting is now widely available; and information access is greatly improved (eg publication of FRAB minutes and documents on the web). The National Audit Office had previously demonstrated some enforcement capacity by its insistence on on-balance sheet treatment under FRS 5A as an audit opinion issue. However, there remains no mechanism for private enforcement (Scott 2002) by users of

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[15] The Treasury is an extremely political department, at the heart of Government economic and political strategy; its ministers are powerful both internally and across government. The following relevant groups within the Treasury with an interest in PPPs can be identified: those charged with developing and promoting PPPs as a policy; microeconomists concerned with the efficiency and effectiveness of government policy; macroeconomists concerned with the performance of the economy as a whole; public expenditure specialists concerned with budgetary process and conformity with the fiscal rules; and accountants concerned with government financial reporting. This last group have traditionally not been prestigious – they have gained prestige since the mid-1990s – and would only prevail internally on a contentious matter if they had the support of other groups. A plausible hypothesis is that the influence of the PPP grouping had waned by the late 2000s.

government accounts: for example, there is no equivalent mechanism to the powers of the Financial Reporting Review Panel to require amendments to audited private sector accounts.

Second, the period between these two decision stages (roughly 2000 to 2006) witnessed important shifts in position. The ASB engaged in domain management activities as it developed its Conceptual Framework for Public Benefit Entities (2003, 2005, 2007). With accounting regulation for listed companies having already shifted to the IASB, together with prospective convergence of UK GAAP on IFRS, the ASB needed to redefine its role. Through time there appears to have been a redefinition of the Treasury interest, perhaps reflecting a changing balance of influence of different groups within the Treasury. The fact that the FRAB had consistently, without effect, complained about PPP accounting indicates that it alone could not have been responsible for the move towards greater on-balance sheet recognition (initially, via FRS 5A without Treasury Technical Note 1 (Revised), then by extending IFRIC 12). The most plausible explanation is that, whereas in the late 1990s the Government wished to expand public investment rapidly by PPPs as well as through conventional procurement, the priority was now to rein back.

Third, there was no public evidence in the late 1990s of any tension between financial reporting and national accounts. Although the 1995 decision to adopt accruals accounting in UK central government was advanced on efficiency and accountability grounds, the change of government in 1997 brought the fiscal rules (golden rule and sustainable investment rule) and therefore a macro-fiscal dimension to the implementation of accruals accounting. During the period 2006 to 2008 national accounts issues hovered in the background to decisions on the financial reporting of PPP projects. The extension of IFRIC 12 decoupled financial reporting from the 'risks and rewards' approach which had been a common feature of FRS 5A, Treasury Technical Note 1 (Revised) and ESA 95. Possibly more significantly, the laxer interpretation of 'risks and rewards' embodied in the Manual on Government Deficit and Debt (Eurostat 2006) allowed a huge expansion of PPP activity, for example in Central and Eastern European countries. This suggests that, irrespective of the financial accounting and reporting methods used to produce

government financial reports and Whole-of-Government Accounts, these may become more detached from the national accounts figures used for fiscal surveillance.

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Table 1: Balance Sheet Treatment of Signed PFI Deals (October 2007)

	Is capital value scored on or off the Departmental Balance Sheet (on/off)?					
	No. of schemes		Total capital value (£m)		Percentage of capital value	
	On	Off	On	Off	On	Off
Cabinet Office	1	1	330	18	95%	5%
Crown Prosecution Service	1	0	0	22	0%	100%
Department for Business, Enterprise and Regulatory Reform	1	2	22	41	35%	65%
Department for Children, Schools and Families	1	114	21	4,762	0%	100%
Department for Communities and Local Government	0	48	0	1,333	0%	100%
Department for Culture, Media and Sport	0	14	0	236	0%	100%
Department for Environment, Food and Rural Affairs	0	17	0	1,508	0%	100%
Department for Transport	21	30	19,938	2,771	88%	12%
Department for Work and Pensions	0	1	0	990	0%	100%
Foreign and Commonwealth Office	1	1	17	74	19%	81%
Health	5	88	243	9,769	2%	98%
Home Office	0	26	0	849	0%	100%
Inland Revenue	1	7	182	658	22%	78%
Ministry of Defence	12	39	2,267	3,495	39%	61%
Ministry of Justice	26	2	725	51	93%	7%
Northern Ireland Executive	7	26	327	737	31%	69%
Scottish Government	3	98	32	4,647	1%	99%
Welsh Assembly Government	1	23	7	515	1%	99%
TOTALS	81	537	24,110	32,475	43%	57%

Source: calculated from http://www.hm-treasury.gov.uk/media/B/E/pfi_signeddeals_231007.xls (last accessed 22 February 2008).

Note: no balance sheet information was available for two Scottish Government schemes, so they have been excluded from these figures.

Figure 1: Analysing Balance Sheet Treatment

On balance sheet of purchaser Off balance sheet of operator 4	On balance sheet of purchaser On balance sheet of operator 1
3 Off balance sheet of purchaser Off balance sheet of operator	2 Off balance sheet of purchaser On balance sheet of operator

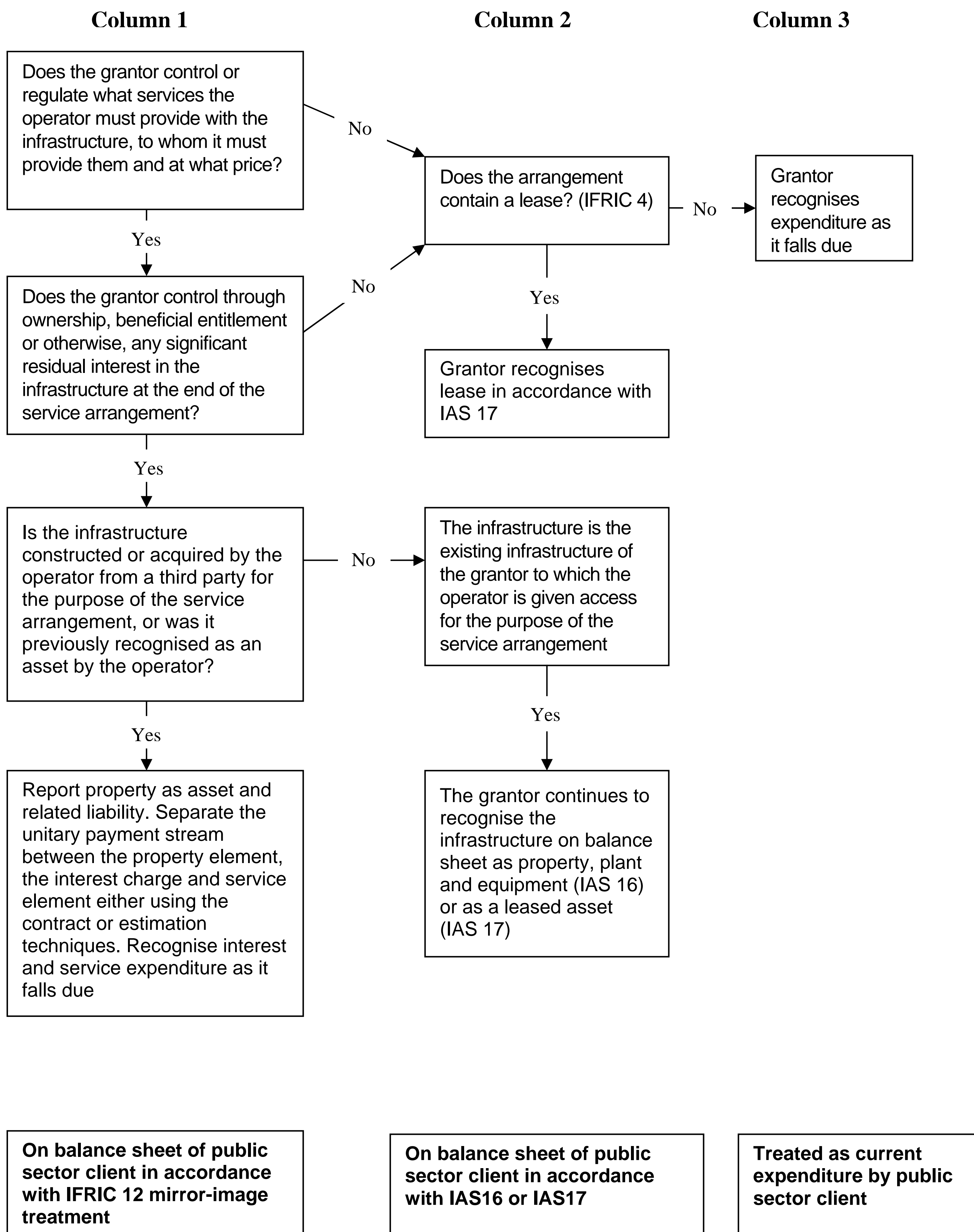
On balance sheet of purchaser

Off balance sheet of purchaser

Off balance sheet of operator

On balance sheet of operator

Figure 2: UK Treasury Flow Chart for Public Sector PPP Client under IFRIC 12



Source: HM Treasury (2008c with additional explanation)