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Submission on the proposed Section PS 3160, Public Private Partnerships

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CUPE

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Dear Mr. Puskaric:

We welcome PSAB's work to establish public sector accounting standards for public private partnerships (P3s). As Canada's largest union, CUPE has a particular interest in public private partnerships. We represent 700,000 workers including in sectors where P3s are in operation and are being proposed such as hospitals, transportation and transit, water and wastewater, schools, recreation facilities, and energy.

We are concerned about the impact of P3s on our members' jobs in the short term, but we are particularly concerned about the impact of P3s on the cost, quality and availability of public services over the long-term. Our members not only work to provide public services, but they also depend heavily on quality public services and infrastructure to maintain a decent standard of living. If the funding for these services and infrastructure is eaten up by P3 projects whose up-front costs are largely hidden up front, then the vast majority of Canadians will be worse off over the longer term.

The growing use of P3s is creating significant long-term public debt obligations which are not reflected in public financial statements. This is a huge concern given that over 200 P3 projects exist across the country. In Ontario alone, the liabilities and commitments for P3 projects grew from $23.5 billion in 2014 to $36.6 billion in 2016—a 56 per cent increase in two years. In the UK, Private Finance Initiative (PFI) liabilities and obligations have reached over £300 billion.[1] This is a massive amount of previously hidden debt/liabilities, equivalent to about C$500 billion, or almost $20,000 per UK family.

Existing public accounting and budgetary practices already provide a strong bias for politicians and governments to use P3s for public infrastructure instead of public financing and operation and maintenance. We encourage PSAB to ensure new accounting standard provides reliable and transparent data on P3s and does not further unfairly incentivize the procurement of infrastructure using P3s.

As mentioned in our 2017 submission on this issue to PSAB, Canada has one of the most active and largest markets in the world for P3 projects, but we also have one of the weakest legislative, accountability and transparency regimes for P3s in the world. It is likely that many of the individuals and organizations that will make submissions to this consultation process have a stake in the P3 industry, which may affect their recommendations. Furthermore, a number of individuals sitting on the PSAB P3 task force and the PSAB board come from companies which profit from the P3 industry.

PSAB needs to ensure those who profit from the P3 industry are not the ultimate beneficiaries of these accounting standards. The public interest and the needs of financial statement users—whether they be members of the public, legislators or analysts—must be top of mind in finalizing the P3 accounting standard.

[1] Dennis Campbell, James Ball and Simon Rogers (July 5, 2012) PFI will ultimately cost £300 billion. The Guardian. https://www.theguardian.com/politics/2012/jul/05/pfi-cost-300bn; Yousseff El-Gingihy (July 13, 2016) If you think there's no money for NHS funding, you'd be right—PFI has sucked it dry. The Independent. http://www.independent.co.uk/voices/nhs-funding-pfi-contracts-hospitals-debts-what-is-it-rbs-a7134881.html

Our submission will focus on three interrelated issues:

(1) the discount rate proposed;

(2) how risk transfer is accounted for; and

(3) presentation and disclosure measures.

From a public interest standpoint, significant changes are required on these issues to ensure the accounting standard meets the needs of citizens, legislators and organizations like CUPE. We hope the proposed PS 3160 will be a starting point to provide greater transparency and accountability for P3s.

Please find below the submission of the Canadian Union of Public Employees on the proposed accounting standard PS 3160, Public Private Partnerships.

RECOGNITION OF INFRASTRUCTURE ASSET

3. Is the control guidance clear as it relates to the recognition of infrastructure? If not, what further clarifications are necessary?

The control guidance regarding recognition of an asset is clear, however, PSAB should provide guidance interpreting the control provisions in a broader manner. At the end of the day, the government is responsible for public infrastructure and delivering public services. In cases of contract failure, the government will ultimately be required to step in and ensure public services are delivered.

For example, when P3 firm Carillion collapsed in 2017, the UK government had to ensure school children were fed, patients received food and laundry was done and that prisons were staffed—all functions included in P3 contracts.[2] This example underlines the need for a broad interpretation of "control" to be used in the proposed PS 3160 because even when public infrastructure is privatized to a significant extent, there is still an implicit guarantee that the government ensures public infrastructure continues to function.

One option to arrive at a broader assessment of control would be that the public sector entity should recognize infrastructure or a betterment to infrastructure where the public entity controls two of the three conditions in paragraph 05 (a-c):

(a) the purpose and use of the infrastructure;

(b) access to the future economic benefits and risks of the infrastructure asset; and

(c) any significant residual interest in the infrastructure at the end of the public private partnership's term.

For example, an infrastructure asset would be recognized where the public sector entity controlled only (a) the purpose and use of the infrastructure and (c) any significant residual interest in the infrastructure at the end of the public private partnership's term. This approach would also minimize the possibility that infrastructure project models would limit the public sector's role and oversight in order to evade P3 reporting requirements.

[2] John Loxley (January 2018) The Collapse of P3 Giant Carillion and Its Implications. Canadian Centre for Policy Alternatives – Manitoba Office.

As for the residual interest needed to indicate control in paragraph 06 (c), CUPE believes the public sector should not need to have a **'significant'** residual interest in the infrastructure asset to indicate "control". The residual interest indicates whether the public sector is affected by the benefits and risks associated with the infrastructure asset beyond the P3 term. Rather, PS 3160 should assess whether the public sector entity has ***any*** residual interest in the infrastructure asset. If so, the condition for control should be met. As previously stated, the government is ultimately responsible for the continued operation of public infrastructure even when particular functions have been privatized through P3s.

However, if PS 3160 continues to require a 'significant residual interest', it is not clear what exactly that would entail. Even if the P3 contract only restricted or denied the private sector partner's ability to sell or pledge the infrastructure, this would indicate a significant degree of control. The ability to sell an asset is a fundamental power within a market-based relationship. The elimination or limitation of this ability shows a significant degree of control over the private sector consortium by the public sector entity.

Recommendations:

- Control guidance should be shifted to require only two of the three conditions listed in paragraph 05 (a-c)
- Change paragraph 06 (c) to remove the word "significant": a residual interest in the infrastructure at the end of the public private partnership's term.
- Clarify that a single element in the list under paragraph .21 can indicate that a significant residual interest exists

INITIAL MEASUREMENT

4. Do you agree the cost of the infrastructure should be measured initially at the infrastructure asset's fair value as proposed in paragraphs .27-.29? If not, what alternative is more appropriate and why?

We agree that the cost of the infrastructure should be measured initially at the infrastructure asset's fair value. However, we are concerned the definition of fair value being used includes the risk profile of the asset. This means an asset procured as a P3 with risk costs capitalized as noted in paragraph 31 could have an entirely different value than an asset procured as a P3 with risk costs in the contract rate. The value of the asset would also be markedly different than the same infrastructure asset procured publicly. This could affect the reliability of the infrastructure asset cost and liability and limit the comparability of asset costs and liabilities.

Paragraph PS 3160.28 defines the fair value of an infrastructure asset as, "*the price a market participant would pay for an equivalent infrastructure asset with the same service potential and risk profile*." This is a different definition of fair value than is used throughout the rest of the Public Sector Accounting Standards Handbook, "*the amount of the consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act*".[3]

[3] Public Sector Accounting Standards Handbook, Section PS 3150, Tangible Capital Assets. Paragraph 05 (c)

If we look at international comparisons such as that used for International Public Sector Accounting Standards (IPSAS) 32, fair value is defined as "*the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction*".[4] This is more akin to the general definition of fair value in the Public Sector Accounting Standards Handbook. Even the International Financial Reporting System (IFRS) definition of fair value makes reference to market participants but not to risk profile, "*the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date*".[5] CUPE questions why risk profile is being included in the definition of fair value given it is not included in other jurisdictions. PSAB should follow global trends when it comes to key accounting definitions such as fair value.

Inclusion of risk profile in the definition of fair value of the asset could also affect the reliability of the cost and liability of the asset on financial statements given that assessments of risk transfer associated with P3s have been questioned across the country. A number of auditors general have conducted thorough audits of P3s including analyses of risk transfer calculations.

A recent federal audit of the Champlain Bridge project found that risk evaluation was not supported by historical data from previous projects, which is recognized as a best practice. Furthermore, the risks of late completion and construction cost overruns were not properly evaluated for the project. The audit found, "*the value-for-money analyses were of little use to decision makers because they contained many flaws favouring the P3 model*".[6]

The Ontario Auditor General's 2014 review of seventy-four (74) P3 projects found that there was no empirical data supporting key assumptions used to assign costs to specific risks. Furthermore, it was the "costing" of risk with these assumptions which that tipped the assessment of whether to select public-sector or P3 procurement.[7]

In 2011, the New Brunswick Auditor General reviewed two school P3s and found that the government did not use historical cost information to determine whether the risk costs were reasonable.[8] In April 2010, the Auditor General of Alberta released a report on the P3 schools noting that risk costs were based on anecdotal evidence. Risk transfer assumptions are generally cloaked in secrecy. When risk transfer assumptions used to justify P3 projects are reviewed, serious methodological questions have been raised. You have the opportunity to correct these failures for "risk calculation" through changes to the accounting standards and should do so.

Reynolds on behalf of the Colombia Institute notes that even projects in the same sector do not necessarily carry the same amount or even similar amounts of risk. For example, one hospital in BC was given a 6.9% risk adjustment while another had a 16.2% adjustment.[9]

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[4] IPSAS 17, Property, Plant and Equipment
[5] IFRS 13, Fair Value Measurement
[6] Office of the Auditor General of Canada (Spring 2018) "Replacing Montreal's Champlain Bridge—Infrastructure Canada", Report 4 in 2018 Spring Report.
[7] Office of the Auditor General of Ontario (December 2014) "Infrastructure Ontario—Alternative Financing and Procurement", Chapter 3.05 in 2014 Annual Report. http://www.auditor.on.ca/en/content/annualreports/arreports/en14/305en14.pdf
[8] Office of the Auditor General of New Brunswick (2011) Department of Supply and Services – Public-Private Partnership: Eleanor W. Graham Middle School and Moncton North School. https://www.agnb-vgnb.ca/content/dam/agnb-vgnb/pdf/Reports-Rapports/2011V3/agrepe.pdf
[9] Keith Reynolds (June 2018) Public-Private Partnerships in British Columbia: Update 2018. Columbia Institute.

One research study of a workshop process to price risks in Britain found the method was open to overestimating the risks retained by the public sector and underestimating risks which that could be controlled under well managed traditional public procurement.[10] It is clear that many analysis and reviews have identified that serious problems with the assumptions and calculations associated with risk transfer exist. PSAB should take this opportunity to address these problems.

Given that international definitions of fair value do not mention risk and that risk assumptions and estimations have been shown to lack reliability, CUPE recommends the removal of 'risk profile' from the definition of fair value. It is already difficult to come to an accurate assessment of fair value for P3s using a market assessment, given that only a limited number of firms are equipped to handle these mega-projects with the result that an active market for P3 infrastructure projects rarely exists.[11] This makes it even more important to wherever possible rely on relevant and observable inputs as mentioned in paragraph 33 of the Exposure Draft.

Recommendations:

- The fair value of an infrastructure asset should be defined as *the price a market participant would pay for an equivalent infrastructure asset with the same service potential*.
- PS3160 should rely on relevant and observable inputs wherever possible

5. Do you agree that specific public private partnership costs required to get the infrastructure asset ready for use should be capitalized as proposed in paragraphs .30-.31? If not, what alternative is more appropriate and why?

We note that this question relates to paragraph 30 with no reference to paragraph 31, which states that the risks related to construction or cost overruns would be included in the capital cost of the asset. We will briefly touch upon the question in paragraph 30 but would like to focus our response to the issue of capitalizing risk in paragraph 31. In our opinion, it is the issue of including risk transfer in capital costs that warrants further discussion and debate.

CUPE does not have a problem with some technical and administrative work prior to the commencement of and during construction being included in "capital costs". However, this should be in line with transaction costs involved with traditional public procurement. P3s are known for their high transaction costs due to the complicated legal structures involved.
A 2014 audit of 74 P3 projects in Ontario found that P3 ancillary costs were $400 million more than the public sector comparator.[12] It is not helpful for accuracy or comparison sake to have P3 assets valued at higher cost and liability amounts simply due to high transaction costs.

To be more explicit, technical and administrative work by P3 consortiums to develop P3 proposals should **not** be included in capital costs. P3 companies bidding on projects should be expected to put in the technical and administrative work necessary to formulate their proposal

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[10] Rob Ball, Maryanne Heafey & David King (2003) Risk transfer and value for money in PFI projects, Public Management Review, 5:2, 279-290
[11] See Office of the Auditor General of Ontario (December 2014) "Infrastructure Ontario—Alternative Financing and Procurement", Chapter 3.05 in 2014 Annual Report; National Audit Office. (2007). Improving the PFI tendering process. London, UK: The Stationery Office; Soliño A. S., & Vassallo, J. M. (2009). Using public–private partnerships to expand subways: Madrid-Barajas international airport case study. Journal of Management in Engineering, 25(1), 21–28.
[12] Office of the Auditor General of Ontario (December 2014) "Infrastructure Ontario—Alternative Financing and Procurement", Chapter 3.05 in 2014 Annual Report.

without the aid of government funding (bid fees). This is especially true for consortiums that are not ultimately selected. These early bid preparation costs which may be reimbursed by governments should not be included in capital costs. We recommend that PSAB provide guidance limiting the amount of technical and administrative costs covered to be consistent with public procurement requirements. The PSAB should be crystal clear about the limited scope of technical and administrative work which would be covered.

PS 3160 deals with risk transfer in two ways. In paragraph 31, the draft proposal suggests design risks, cost overruns etc. should be included in the capital cost of the asset. Risk transfer assumptions would also be included when the contract rate is used as the discount rate.

As previously indicated, many researchers and auditors have highlighted the flawed or exaggerated assumptions used to calculate the value of risk that is transferred from the public sector to the private sector in P3 contracts.[13] Yet the" value" of this assumed risk transfer is often the primary rationale provided for choosing a P3 model rather than traditional public sector procurement. Given this context, the proposed accounting standard should provide detailed financial information on how costs associated with risk transfer are determined. This should be reported on as a separate item in financial statements.

From a public policy perspective, risk transfer calculations should be transparent and clearly ascertained. The first proposed PSAB option of reporting risk buries the cost of risk transfer in the capital cost of the asset, which would make it difficult if not impossible to separate out and assess.

Whereas the second option involves a significant and unwarranted leap of faith that the amount the private sector is charging the public sector for financing in addition to profit appropriately reflects risk transfers. Having two different methods of risk transfer calculation will inevitably lead to confusion, reduced reliability and problems with comparability of P3 financial reporting.

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[13] See Office of the Auditor General of Canada (Spring 2018) "Replacing Montreal's Champlain Bridge—Infrastructure Canada", Report 4 in 2018 Spring Report; Office of the Auditor General of Ontario (December 2014) "Infrastructure Ontario—Alternative Financing and Procurement", Chapter 3.05 in 2014 Annual Report. http://www.auditor.on.ca/en/content/annualreports/arreports/en14/305en14.pdf; Office of the Auditor General of New Brunswick (2011) Department of Supply and Services – Public-Private Partnership: Eleanor W. Graham Middle School and Moncton North School. https://www.agnb-vgnb.ca/content/dam/agnb-vgnb/pdf/Reports-Rapports/2011V3/agrepe.pdf; Keith Reynolds (June 2018) Public-Private Partnerships in British Columbia: Update 2018. Columbia Institute; Rob Ball, Maryanne Heafey & David King (2003) Risk transfer and value for money in PFI projects, Public Management Review, 5:2, 279-290

Risk transfer should be dealt with in one way throughout the proposed PS 3160. The appropriate manner is to determine risk transfer and report it separately in financial statements, with full disclosure of all assumptions and formulas used, as part of PS 3160. This reporting should break down the types of risks involved, and the cost associated with each type of assumed risk transfer.

The proposed PSAB treatment of risk transfer is fundamentally different than that used in the UK where in 2003, the government moved from a 6 per cent discount rate to a 3.5 per cent rate to explicitly reflect the social time preference rate (STPR). The UK's Green Book states, "*In addition, there is no allowance for project specific risk in the STPR as risks should be identified and costed explicitly in appraisal. This approach to the STPR contrasts with private sector discounting which incorporates allowances for the cost of raising capital and compensation for risk.*"[14] This approach recognizes the important role of assumed risk transfer in decision making to move forward with the PFI/P3 model. Explicit risk calculations allow for greater transparency and accountability in decision making about infrastructure procurement.

Recommendation:

- The assumed value of risk transfer should be calculated in a single way in PS 3160 and reported on in an itemized and transparent manner

6. Do you agree that, where costs of the infrastructure are not readily available or the annual service payments are not separable, the relative fair value approach as proposed in paragraphs 32-34 is an appropriate method to estimate fair value of the infrastructure asset and the service contract (illustration of this guidance in Example 4 – Expansion of bridge for tourism)? If not, what alternative is more appropriate and why?

Paragraph 32 of the Exposure Draft notes that it may be difficult to determine the portion of P3 contract costs which would go to operations and maintenance expenses versus the cost of the infrastructure asset. CUPE is concerned that P3 contracts are being negotiated where these breakdowns are not clear to the public sector entity. Furthermore, given that the private sector consortium will not be subject to the new P3 accounting standard nor broader public sector accounting standards, that information may not be readily available.

CUPE agrees the estimation techniques proposed in paragraphs 32-34 are appropriate for estimating the relative fair value, but only if the discount rate is modified. It is critical that operations and maintenance costs are separated from P3 capital costs for financial reporting purposes. When the P3 contract does not include this separation, valuation techniques will need to be used. CUPE is supportive of the recommendation to maximize the use of relevant and observable inputs and minimize the use of unobservable inputs in paragraph 33.

At the same time, the valuation technique proposed in 34 (a), (present value of discounted future cash flows), could result in an infrastructure asset which is undervalued when using the contract rate as the discount rate. This could also result in the same infrastructure asset being valued at entirely different costs depending on the contract rate used in the project. This does not lead to transparency and clear comparisons.

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[14] HM Treasury (2018) The Green Book: Central government guidance on appraisal and evaluation. Retrieved from https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/685903/The_Green_Book.pdf

It is obvious some P3 projects were initially undervalued when we learn how the projects have been valued later in the contract. Some equity stakes in P3s have been resold through the secondary market for significant profits.[15] In the UK, P3 equity sales have resulted in an annual 28.7% rate of return, more than double the expected rate of return stated in project business cases.[16] It is important to accurately reflect the true value of P3 infrastructure assets because this affects the government's debt and liabilities. Understating P3 debt can lead to poor short-term budgeting decisions around how to allocate resources.

Recommendation:

We agree with the estimation techniques proposed with the caveat that a lower discount rate (public sector cost of borrowing or social time preference rate) is used.

7. Do you agree existing infrastructure that has been bettered using a public private partnership should be measured at its carrying amount plus costs associated with the betterment of the existing infrastructure? If not, what alternative is more appropriate and why?

CUPE agrees that where an existing infrastructure asset has been bettered, it should be measured at its carrying amount plus costs associated with the betterment. At the same time, we would like to take this opportunity to discuss the "useful life" guidance provided in paragraph 42 of PS 3160 and paragraph 50 of the basis of conclusions, which suggests that the estimated useful life of P3 assets may be beyond historical averages for that particular asset class as a result of contractually required maintenance requirements or the use of longer lasting materials.

While the theory behind P3s may indicate that this may be the case, there is little empirical evidence to verify this assumption according to Boardman, Siemiatycki and Vining. They contend, "*even if the original budget allocates funds for maintenance, this is no guarantee that maintenance will be performed optimally or that the facility is, at the end of the contract term, transferred to the public sector in accordance with the value or in the condition specified in the contract*". [17]

The assumption around "useful life" in PS 3160 is difficult if not impossible to independently verify given that few P3 contracts have ended their life in Canada. Furthermore, the useful life of P3 infrastructure assets could be reduced given the fact that private consortiums may be motivated to cut costs in order to maximize profits.

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[15] In Canada, over 20 equity sales have occurred as of 2016. This is expected to grow as most Canadian P3s were only developed in the past 5-10 years. See Heather Whiteside (2016) Austerity Infrastructure: financializing, offshoring, and tax sheltering public-private partnership funds.

[16] Dexter Whitfield, "PPP Profiteering and Offshoring: new Evidence" European Services Strategy Unit, October 2017. https://www.european-services-strategy.org.uk/wp-content/uploads/2017/10/PPP-profiteering-Offshoring-New-Evidence.pdf

[17] Anthony E. Boardman, Matti Siemiatycki and Aidan R. Vining (March 2016) The theory and evidence concerning public-private partnerships in Canada and elsewhere. University of Calgary School of Public Policy Research Paper.

Some recent analyses highlight problems with the P3 model which could potentially reduce the useful life of an infrastructure asset such as contractual disputes regarding maintenance, some maintenance not being included in the P3 contract or the possibility of materials being selected based on bare minimum requirements in the contract.[18]

These examples suggest the PSAB should not include guidance regarding "useful life" being extended through the P3 model in PS 3160.

SUBSEQUENT MEASUREMENT

9. Do you agree that when a contract rate cannot be observed or reliably derived to calculate finance charges, then another appropriate rate should be used as proposed in paragraph .58? If not, what alternative is more appropriate and why?

We note PSAB has not asked about the appropriate discount rate to be used in PS 3160. It is unclear why PSAB is not soliciting feedback on this issue given that the scope, control and presentation and disclosure measures are still being explicitly questioned. The discount rate is a critical issue that warrants further discussion and debate. CUPE is clear the discount rate, which determines the present value of future cash flows associated with the P3, should be the public sector's long-term cost of borrowing.

The proposed accounting standard would significantly change how P3 projects are accounted for in many jurisdictions across the country. It would institute a much higher discount rate than is generally used when accounting for P3s, which could affect whether the public sector entity pursues a P3 infrastructure model.

As previously indicated, in the audit of the Champlain Bridge, the Auditor General of Canada found that the higher discount rate used in the value for money analysis favoured the P3 model.[19] This higher discount rate could also understate P3 liabilities and net debt, limit transparency and comparability of P3 projects and potentially incentivize the procurement of infrastructure using P3s covered under the scope of PS 3160. Though there is no consistent P3 accounting standard, many jurisdictions currently use the lower long-term public sector cost of borrowing as the discount rate, which provides a more accurate determination of P3 liabilities and would allow for greater comparability across jurisdictions.

The discount rate being proposed in PS 3160.56 to determine the finance charge is referred to as the contract rate. This is defined in paragraph PS 3160.05(c) as: "*the cost of financing that the private sector partner is charging the public sector entity in the public private partnership*." This cost would at a minimum be the higher private sector borrowing rate. It would likely also include an additional profit margin and premium based on the credit risk associated with the public sector entity. There are several reasons why the proposal to use the contract rate is problematic.

Understating P3 liabilities and net debt: Using a higher discount rate as proposed in PS 3160.56 would result in a lower net present value associated with the infrastructure asset. As

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[18] See Office of the Auditor General of Ontario (December 2017) Real Estate Services, Section 3.11 in 2017 Annual Report; CBC News (October 28, 2019) Slippery LRT tiles proof you get what you pay for: architect; Aaron Derfel (December 10, 2007) MUHC headed for costly failure, top architect warns. Montreal Gazette. Alex Macpherson (January 21, 2020) Early 'concerns' over roof at Sask. Hospital 'were well-founded': email. Saskatoon Starphoenix.
[19] Office of the Auditor General of Canada (Spring 2018) "Replacing Montreal's Champlain Bridge—Infrastructure Canada", Report 4 in 2018 Spring Report.

noted in Alberta’s P3 Framework and Guidelines, “*increasing the discount rate by adding a risk premium would lead to illogical results when evaluating project costs as a riskier project (with a higher discount rate) would have a lower net present value cost than a less risky project (with a lower discount rate)*”. This outcome would be even more pronounced given the long-term horizon of P3 financial commitments. Using the “contract” rate would likely result in P3 liabilities and the net debt being under-reported.

Accounting standards should provide accurate information about the government’s financial position and the allocation and use of economic resources. Our concern is that the long-term liabilities which arise from P3 contracts will not be accurately reflected on government financial statements with the proposed accounting standard changes. Accurate knowledge about financial obligations is particularly important for forecasting future cash flow requirements. This situation could lead to problematic public policy choices given that the net debt may be understated.

A public sector discount rate fosters transparency: A significant benefit of using the public sector entity’s incremental cost of borrowing (the average cost of borrowing for a public entity to finance the project itself) is that this rate is more reliable than the “contract” rate since it is based on observable inputs that can be independently verified. A core concept of public sector accounting is that the use of relevant and observable inputs should be maximized, and the use of unobservable inputs should be minimized. This concept is even stated in paragraph 33 of proposed Section PS 3160 itself when discussing the use of estimation techniques. As a result, there would be less uncertainty with regards to estimates if the public sector entity’s incremental cost of borrowing were used.

In contrast, the complexities involved with determining the “contract” rate would mean this rate would be more difficult to independently verify and assess. In fact, paragraph PSG-2.17 acknowledges that it can be difficult to determine the contract rate in an arrangement, since the paragraph explicitly states that when the implicit rate (contract rate) is ‘not practicable to determine’ the public sector entity’s incremental cost of borrowing would automatically be used instead.

Consistency and comparability: The public sector entity’s incremental cost of borrowing would typically be easier to determine than the contract rate since the inputs that would go into the public sector’s rate are observable. This would be more straightforward for entities to apply in practice and would help to ensure consistent and comparable results when public sector entities are applying the standard. It is also the rate that is typically used by public sector entities such as Alberta, Saskatchewan, Ontario and the federal government, which all use their own cost of borrowing as the discount rate for P3s. This would lead to a more accurate comparison of P3 infrastructure liabilities across jurisdictions.

Incentivizing P3s: We encourage PSAB to consider how the proposed accounting standard could influence decision-making with regards to the choice of infrastructure procurement model. Accounting standards should not unduly influence decisions about whether to use public sector or P3 infrastructure procurement. Our analysis indicates that the use of the contract rate as the discount rate could result in some governments with a short-term focus opting for P3s covered by the scope of this standard, so the initial value of the liability is lower.

This is because shorter term Design, Build, Finance contracts will still use the government's cost of borrowing as the discount rate whereas longer term finance contracts with operations and maintenance would use the contract rate, a significant difference in accounting practice and result. The proposed P3 accounting treatment will not accurately reflect the true long-term cost of P3 liabilities and debt.

The value of the project to the government: The contract rate should reflect the value of the project to the public sector not the value of the project to the private sector. Use of the contract rate is not appropriate because its purpose is to compensate the private sector for the presumed risk transfer. It would be inconsistent to return those risks to the public sector through the discount rate. The contract rate reflects the cash flows which are paid or received by the project. This rate of return reflects the risks of the project's cash flows. The public sector is obligated to make payments to the private sector consortium in a P3 arrangement whereas the private sector takes on the risk of non-payment. The discount rate used should be from the perspective of the public sector entity, not the private sector entity who bears the risk of non-payment. Therefore, the government's incremental cost of borrowing more fairly reflects the value of its obligations.

However, if PSAB is not prepared to recommend that the appropriate public sector borrowing costs be used as the discount rate, public sector entities should be required to report the nominal contractual cash flows and equivalents (in the case of non-financial considerations), as the UK and Portugal have done, and as is recommended by IMF experts.[20]

Recommendation:

- Modify paragraph 56 to state that the government's long-term cost of borrowing would be used for the purposes of expense recognition over the course of the arrangement instead of the contract rate.
- If the contract rate is used, public sector entities should report on the nominal contractual cash flows and equivalents for non-financial considerations.

PRESENTATION AND DISCLOSURE

10. Do you agree with the disclosure requirements? If not, what changes would you make to these requirements, and why?

We recommend more robust presentation and disclosure requirements as part of PS 3160 in order to enable financial statement users to understand the economic ramifications of P3s. As a starting point, the P3 accounting standard should ensure disclosure requirements are reflective of other accounting standards dealing with infrastructure (PS 3150) and partnerships (PS 3060). We strongly support the requirement that operating and maintenance payments, as well as any other payments, or minimum revenue guarantees or non-performance deductions, be itemized.

CUPE also encourages PSAB to revisit the presentation and disclosure measures to ensure risk transfer assumptions are clearly shown, projects are reported upon individually and by sector, and financial statements include measures which allow financial statement users to understand the scope and impact of P3 procurement.

[20] Funke, K., T. Irwin and I. Rial (2013), "Budgeting and Reporting for Public-Private Partnerships", International Transport Forum Discussion Papers, No. 2013/07, OECD Publishing, Paris. /www.itf-oecd.org/sites/default/files/docs/dp201307.pdf

Paragraph 62 of the “Basis for Conclusions” says that “disclosures not be burdensome”. However, given the lack of transparency in P3 projects, which make them difficult to independently assess, financial statements provide a key space where information should be made accessible. This would help improve the accountability and oversight of P3 projects. Furthermore, as a financial statement user, CUPE has concerns with the advice provided in paragraph 64 of the Basis for conclusions that there is no obligation to disclose the financial information on the P3 infrastructure asset twice if it is provided through other accounting standards. Most financial statement users are not going to understand the intricacies of where a jurisdiction chooses to report on P3 assets; ensuring all relevant information on P3 infrastructure is included in one place makes the information more accessible and user-friendly. Given that the financial information is already being produced, it should not be burdensome to include it in financial statements relating to PS 3160. We expressly disagree with the advice provided in paragraph 64.

Recommendation:

Disclose all required information on P3 infrastructure assets in the government’s financial statements under PS 3160.

The transfer of risk from the public sector to the private sector is the primary justification for the use of P3s. Currently, the proposed standard would include risk calculations in the discount rate and/or in the cost of the asset (PS 3160.31). Our response to Question 4 identified serious shortcomings in the assumptions and valuation techniques involved with risk transfer. Given the importance of these calculations in the choice of infrastructure model, it is vital that risks assumed to be retained by the government and those to be transferred to the private sector consortium be itemized in financial statements with complete information describing any estimation techniques.

Recommendation:

Report on the value and types of risk which are assumed to be transferred and retained through an itemized list in order to allow for greater transparency and accountability.

CUPE is also concerned that the presentation and disclosure features of the proposed standard would involve bundling of projects together rather than reporting individually. It is important that financial statement users are able to assess projects on an individual basis as well as by sector. For example, if a member of the public wants to understand the fiscal impact of a P3 hospital, school or water treatment plant in their community, they should have the information provided in financial statements to do so. We recommend reporting on projects individually or at a minimum by type of institution (e.g. hospital, school, water infrastructure).

Recommendation:

Report on projects individually or at a minimum by type of institution (e.g. hospital, school, etc.)

CUPE recommends strengthening the wording related to financial liabilities in paragraph .69 to ensure they are reported by the public sector entity for P3 projects. This would include deductions related to non-performance, minimum guarantees the public sector commits to providing the private sector consortium as well as renegotiations or repricing. All of these involve significant financial liabilities for the public sector entity. Furthermore, operations and maintenance costs should be reported separately.

Recommendation:

- Alter the wording of paragraph 69 to: For financial liabilities, significant terms of the arrangement would include minimum guarantees, renegotiations, deductions related to non-performance, etc.
- Report on operations and maintenance costs in financial statements

We also recommend that PSAB include financial information which allows for a greater understanding of the role of P3 procurement in public infrastructure development. Firstly, financial statements should include the proportion of overall infrastructure that is developed using a P3 model. P3s are a controversial model that have been the subject of much debate regarding their high cost and reduced accountability.[21] The decision to use a P3 locks future generations into long-term financial obligations that can affect revenue and spending options 20 or 30 years down the line. As such, the public has the right to know what proportion of infrastructure spending involves a P3s procurement model.

Secondly, if the standard makes use of the contract rate as the discount rate, CUPE recommends that disclosure includes a discussion of the public sector's borrowing rate in comparison with the contract rate in order to explain how much more it cost to build infrastructure assets using the P3 model versus public procurement. This would give a more complete understanding of the government's financial health in the context of the economic and financial environment.

Recommendation:
Financial statements should include the proportion of infrastructure spending that is through the P3 procurement model and a discussion of the public sector's borrowing rate in comparison with the contract rate in order to understand the opportunity cost of P3 procurement.

Overall, CUPE feels that PSAB can play a leadership role in creating an accounting standard for P3s that shows leadership on transparency and accountability. As a matter of comparison, the International Public Sector Accounting Standards include significant disclosure obligations.[22] We urge the PSAB to impose similar disclosure obligations.

We encourage the PSAB to be an international leader ensuring P3 projects are subject to transparent and stringent accounting standards. It is essential that the public, legislators, councillors and analysts are provided with rigorous and accurate financial information to better inform and influence our current and future public policymaking.

TRANSITIONAL PROVISIONS

11. Do you agree with the proposed transitional provisions? If not, what changes would you make to these requirements, and why?

Yes, CUPE agrees with the proposed transitional provisions.

SR:kd/cope491

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[21] See Heather Whiteside (2015) Purchase for Profit: Public-Private Partnerships and Canada's Public Health Care System. University of Toronto Press; John Loxley and Salim Loxley (2010) Public Service, Private Profits: The Political Economy of Public-Private Partnerships in Canada. Fernwood Publishing; Keith Reynolds (June 2018) Public-Private Partnerships in British Columbia: Update 2018. Columbia Institute.
[22] IPSAS 32, paragraph 32-33