PROTECTING TRANSPARENCY AND ACCOUNTABILITY:

KEY POINTS ON A P3 ACCOUNTING STANDARD THAT SERVES THE PUBLIC INTEREST

The Public Sector Accounting Board (PSAB) is currently developing an accounting standard on public-private partnerships (P3s). They have produced an Exposure Draft, which outlines how they intend to proceed with the new accounting standard Section PS 3160. CUPE is concerned about the high discount rate being proposed and that the presentation and disclosure features will not shed sufficient light on P3 projects.

This new accounting standard will apply to all P3 infrastructure across the country whether developed by municipalities, provincial governments or the federal government. P3s cost the public more, hurt workers and operate in secrecy. We need to ensure these new accounting rules do not create advantages for governments to build infrastructure using P3s. Furthermore, we need to ensure that advocates and members of the public can access information about secret P3 deals through the disclosure requirements of the new accounting standard.

The task force developing the accounting standard has three members from law and consultancy firms who profit from the P3 industry. Most individuals and organizations making submissions will have a direct stake in the P3 industry. We need to ensure the voices of workers and citizens are represented.

We encourage organizations and individuals to make their voices heard. You can make written submissions (in a Word file) on the Exposure Draft by clicking the Submit Comments button here or send by email to info@psabcanada.ca until February 29, 2020. You can find a copy of the exposure draft here. The points below can be used and adapted by your organization, and will form the basis of CUPE's submission.

Public considerations cannot be put aside in order to achieve an accounting standard. A new standard should ensure the high cost of P3s is accounted for in a fair and accurate way that benefits the public interest rather than corporations and private profit.

Overview

Our organization welcomes PSAB's initiative to establish public sector accounting standards for public-private partnerships (P3s). The growing use of P3s is creating significant long-term public debt obligations that aren't reflected in public financial statements. Existing public accounting and budgetary practices provide a strong bias for politicians and governments to use P3s for public infrastructure instead of public financing and operation. We encourage PSAB to ensure new accounting standards do not incentivize the procurement of infrastructure using P3s.

Many of the individuals and organizations who 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 profiting from the P3 industry. PSAB will need to ensure those who profit from the P3 industry are not the ultimate beneficiaries of these accounting standards. The public interest must be top of mind in finalizing the P3 accounting standard.

Overall, our organization feels that the scope of the standard should not be reduced (question 1)—all types of infrastructure development should be covered by a relevant accounting standard. With regards to the control guidance (question 3), we believe a broad approach should be taken to recognition of the asset. The reality is that the ultimate risk and responsibility for ensuring that public infrastructure continues to operate and public services are delivered remains with the government, regardless of the infrastructure procurement model.

Our submission will focus on two major points with regards to the Exposure Draft on P3s: discount rates (question 4 and 9) as well as presentation and disclosure (question 10). As [public sector unions], we rely on information provided in financial statements to understand the government's financial position. This information helps us intervene in public policy debates on the use of public funding for public services and infrastructure that our members work in and access as members of the public. As financial statement users, we encourage PSAB to issue a standard that has comprehensive disclosure requirements for P3s.

Discount rate

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. This higher discount rate would 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 public sector discount rate, which provide a much more accurate determination of P3 liabilities and would allow for greater comparability across jurisdictions.

The discount rate being proposed in the 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 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)".[1] 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.[2] Our concern is that the long-term liabilities committed to in P3 contracts will not be accurately reflected on government financial statements. 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

[1] Alberta Treasury Board (March 2011) Alberta's Public-Private Partnership Framework and Guideline.
[2] See PS 1000.19 about information users look for in financial statements.

proposed Section PS 3160 itself when discussing the use of estimation techniques. As a result, there would be less uncertainty with regards to estimates when the public sector entity's incremental cost of borrowing is used.

In contrast, the complexities involved with determining the contract rate would mean it 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 it 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 this 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. 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 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 DBF 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.

Clear calculation of risk transfer: Many analyses have pointed to concerns regarding the assumptions used to calculate the value of risk that is transferred from the public sector to the private sector in P3 contracts.[3] In fact, the assumed risk transfer is the key rationale provided for why the P3 model is selected. Given this context, the proposed accounting standard should provide a framework for how risk transfer is determined, ensuring it is reported on as a separate item in financial statements.

In the proposed PS 3160, risk is dealt with in two ways. If the contract rate is used as the discount rate, this rate would incorporate an assessment of risk. Secondly, paragraph PS 3160.31 states that risks the private sector partner is compensated for, such as construction related risks, design risks, cost overruns, etc., would be included in the cost of the infrastructure asset. Using the first option, assuming that the amount the private sector is charging the public sector for financing appropriately reflects risk transfers involves an enormous and unwarranted leap of faith about the efficiency of these markets especially given that a few large firms dominate the P3 market in

[3] See Office of the Auditor General of Ontario, "Infrastructure Ontario—Alternative Financing and Procurement", Chapter 3.05 in 2014 Annual Report, December 2014. http://www.auditor.on.ca/en/content/annualreports/arreports/en14/305en14.pdf; Office of the Auditor General of Ontario, "Brampton Civic Hospital Public-private Partnership Project", Chapter 3.03 in 2008 Annual Report, December 2008; Matti Siemiatycki & Naeem Farooqi (2012): Value for Money and Risk in Public–Private Partnerships, Journal of the American Planning Association, 78:3, 286-299; Keith Reynolds (2018) Public-Private Partnerships in British Columbia: Update 2018. Columbia Institute.

Canadian jurisdictions.[4] Using the second option buries the cost of risk in the capital costs of the asset and makes it difficult if not impossible to separate. Neither option is advisable. Risk transfer should be determined and reported on separately, with full disclosure of all assumptions and formulas used, as part of PS 3160.

The proposed treatment of risk 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 society's preference for consumption now over consumption in the future. They moved to pricing risks individually.

Presentation and disclosure (Question 10)

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. 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.

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). Given the importance of these calculations in the choice of infrastructure model, it is vital that all risk calculations are itemized in financial statements with complete information describing any estimation techniques.

Our organization is also concerned that the presentation and disclosure features of the proposed standard would allow the 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).

We also recommend that financial statements 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.[5] 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 is as a result of P3s.

We encourage the PSAB to ensure P3 projects are subject to transparent and stringent accounting standards. It is essential that legislators, policy-makers and members of the public are provided with rigorous and accurate financial information to better inform and influence our current and future public policy-making.

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[4] See Office of the Auditor General of Ontario, "Infrastructure Ontario—Alternative Financing and Procurement", Chapter 3.05 in 2014 Annual Report, December 2014. http://www.auditor.on.ca/en/content/annualreports/arreports/en14/305en14.pdf

[5] See Christopher Majka (June 4, 2019) Highway Robbery: Public Private Partnerships and Nova Scotia Highways. Canadian Centre for Policy Alternatives; CCPA NS (June 14, 2016) Private Profit at a Public Price: Deciding the Future of the Public-Private Partnership Schools in Nova Scotia; Heather Whiteside (2015) Purchase for profit: public-private partnerships and Canada's public health care system.