LIBRARY of PARLIAMENT
BIBLIOTHÈQUE du PARLEMENT

IN BRIEF

Public-Private Partnerships: Are Canadians Getting the Full Picture?

Publication No. 2015-50-E
26 June 2015

Lindsay McGlashan

Economics, Resources and International Affairs Division
Parliamentary Information and Research Service

Papers in the Library of Parliament's ***In Brief*** series are short briefings on current issues. At times, they may serve as overviews, referring readers to more substantive sources published on the same topic. They are prepared by the Parliamentary Information and Research Service, which carries out research for and provides information and analysis to parliamentarians and Senate and House of Commons committees and parliamentary associations in an objective, impartial manner.

Public–Private Partnerships: Are Canadians Getting the Full Picture?
(In Brief)

Publication No. 2015-50-E

Ce document est également publié en français.

CONTENTS

1 INTRODUCTION 1

2 PUBLIC-PRIVATE PARTNERSHIPS 1

3 FINANCIAL REPORTING IN RELATION TO PUBLIC-PRIVATE PARTNERSHIPS 2

3.1 General Considerations 2

3.2 Challenges 2

3.3 International 3

3.4 United States 3

3.5 Canada 4

3.5.1 Federal Government 4

3.5.2 Provincial Governments 4

4 NEXT STEPS 5

5 CONCLUSION 6

PUBLIC-PRIVATE PARTNERSHIPS: ARE CANADIANS GETTING THE FULL PICTURE?

1 INTRODUCTION

Increasingly, governments around the world are turning to public-private partnerships (P3s) to provide complex and large-scale infrastructure. The shift to P3s can be attributed to several factors, such as the growing need for infrastructure development and renewal, the continued effort to achieve efficiencies in the public sector, and the reality that most governments face ongoing budget constraints.

In Canada, recent examples of federal P3s include the Long-Term Accommodation Project for the Communications Security Establishment and the New Bridge for the St. Lawrence Corridor Project. In addition, the federal government promotes the use of P3s for public infrastructure projects by other levels of government through PPP Canada, the federal agency responsible for the promotion of P3s. PPP Canada manages the five-year $1.25-billion P3 Canada Fund, which supports provincial, territorial and municipal P3s.

The federal government publishes several documents that present different components of its financial situation and performance and help ensure accountability to Canadians and Parliament. The growing importance of P3s raises the question: Are Canadians getting the "full picture" when financial information is reported in relation to P3s?

This paper provides a brief overview of P3s and discusses accounting standards and reporting challenges related to P3s. It also discusses further steps that could be taken to enhance financial reporting in relation to P3s.

2 PUBLIC-PRIVATE PARTNERSHIPS

The term P3 is used to describe a long-term, performance-based approach to procuring public infrastructure.[1] Under these contractual arrangements, responsibility for components of a public-sector project – ranging from design and planning to long-term maintenance – is transferred to the private sector, which thereby assumes a significant share of the project's financing and risks.[2]

The extent of private-sector involvement and the associated transfer of risks are typically used to differentiate among the various types of P3 delivery models: design-build-finance (DBF), design-build-finance-maintain (DBFM), and design-build-finance-operate-maintain (DBFOM), among others. Service concession arrangements[3] are another type of P3.

Generally, an analysis is performed to determine which model would deliver the desired asset at the lowest cost when all factors, including asset life, risk and the time value of money, are considered.

In the Canadian federal government context, P3s are characterized by:

- the provision of capital assets and associated services to realize a defined outcome;
- the completion of multiple project phases by a single private-sector partner;
- a transfer of risk to the private sector; and
- a performance-based payment mechanism.[4]

This definition, employed by PPP Canada, is notably narrower than the array of P3 delivery models that exist internationally.

3 FINANCIAL REPORTING IN RELATION TO PUBLIC-PRIVATE PARTNERSHIPS

3.1 GENERAL CONSIDERATIONS

Financial statements are prepared in accordance with relevant accounting standards, which tend to be either rules-based or principles-based standards.[5] The relevant accounting standards can vary from one jurisdiction to the next, and those applicable within a jurisdiction may differ for public- and private-sector reporting entities.

Financial reporting in relation to P3s is important for Canadians and Parliament because the public-sector partner is accountable for the proper administration of its resources. Thus, information in relation to P3s should be adequately disclosed to demonstrate how effectively assets are being managed and to identify what risks, or fiscal exposures, are associated with those P3s.

3.2 CHALLENGES

Accounting and reporting in relation to P3s can be complex, in part because of the size of the projects, the long-term risks involved and the project-specific nature of the contract terms. This complexity presents several challenges, mainly with respect to the following:

- **Economic substance.** Financial statements should reflect the economic substance of a transaction, which in turn provides users with information for better decision-making. For P3s, elements such as control, ownership of the constructed assets and responsibility for liabilities in relation to project payments should be accounted for and reported in a way that presents the economic substance of the contractual arrangement.
- **Allocation of cost components.** A P3 project may have various cost components, such as capital assets, operating and maintenance costs and/or financing costs, and possibly incentives for the private-sector partner as well. The public- and private-sector partners need to determine how they will allocate payments among those cost components in order to properly reflect the costs in

their financial statements, including selecting the appropriate discount rate[6] to be used for the financing component.

- **Additional financial information to disclose.** Relevant financial information in relation to P3s may be disclosed in audited financial statements, in accompanying unaudited information, or in P3 project summaries, which are often made publicly available. Decisions about what additional information to disclose should take into account not only the dollar value of the project in relation to the size of the public-sector reporting entity, but also the risks involved.

3.3 INTERNATIONAL

International standards and best practices in relation to accounting and reporting for P3s have evolved in recent years. Many jurisdictions follow International Financial Reporting Standards (IFRS), which are principles-based standards developed by the International Accounting Standards Board, an independent standard-setting body. International Public Sector Accounting Standards (IPSAS) are similar to IFRS but are adapted to the public sector (i.e., governments).

Certain countries that follow accounting standards based on IFRS, such as the United Kingdom and Australia, recognize government-funded P3s[7] on the government's balance sheet.[8] Amounts related to these P3s are typically aggregated on the balance sheet under relevant categories, for example under the category tangible capital assets. However, not all jurisdictions follow IFRS or IPSAS.

3.4 UNITED STATES

In the United States, the Federal Accounting Standards Advisory Board is responsible for developing accounting standards; these standards are widely considered to be rules based. The Board has recently undertaken a project to increase transparency in relation to the full costs of P3s.[9] In an accounting standards draft released for comment in October 2014, *Public-Private Partnerships Disclosure Requirements*, the Board noted "that there is a need for disclosure requirements specific to the fiscal exposures existing in P3s."[10]

The draft standard includes a proposed definition for P3s, as well as a list of characteristics to assess which of these P3s should be subject to disclosure requirements. The proposed disclosure requirements include:

- the purpose, objective and rationale for the P3;
- the relative benefits or revenues being received in exchange for the government's consideration, whether monetary or non-monetary;
- the entity's statutory authority for entering into the P3;
- the amount of federal and non-federal funding to support the P3;
- the operational and financial structure of the P3, including rights and responsibilities;

- the significant contractual risks that the P3 partners are undertaking; and
- other aspects such as any significant instances of non-compliance with legal and contractual provisions governing the P3 arrangement or transaction.[11]

3.5 Canada

In Canada, generally accepted accounting principles (GAAP) include IFRS and Canadian public-sector accounting standards (PSAS). These standards are widely considered to be principles based.

For the most part, Canadian public-sector entities – such as federal, provincial and territorial governments – prepare their financial statements in accordance with Canadian PSAS.

3.5.1 Federal Government

The federal government publishes audited consolidated financial statements in the *Public Accounts of Canada*. These statements are prepared using the government's accounting policies, which are based on Canadian PSAS. PSAS does not provide specific guidance in relation to accounting for P3s, and the Treasury Board of Canada Secretariat has not developed accounting policies or guidelines that specifically address financial reporting for federal P3s.

The audited consolidated financial statements are highly aggregated, and as a result no specific details of federal P3s appear in the statements or their related notes. However, supplementary unaudited financial information in relation to various federal P3s is presented in Volumes I, II and III of the *Public Accounts of Canada*.

- **Volume I** of the *Public Accounts of Canada* includes detailed information about the total estimated costs and the amounts contracted in relation to the "capital asset" component[12] and the "purchases" component[13] of P3s, the amounts that have been disbursed to date, and the outstanding obligations in relation to those components.
- **Volume II** of the *Public Accounts of Canada* presents the financial operations of the federal government, segregated by ministry, including the authorities provided to PPP Canada.
- **Volume III** of the *Public Accounts of Canada* includes detailed information on the acquisition of land, buildings and works, such as the name and location of contractors involved in federal P3 projects.

3.5.2 Provincial Governments

Several provincial governments have developed specific policies, guidance or standards related to P3s.

For example, Ontario announced its intention to be more transparent when accounting for capital assets, including those provided through P3s.[14] In its consolidated financial statements, under the summary of significant accounting policies, the province of Ontario discloses that infrastructure procured through alternative financing and procurement,[15] such as P3s, are recorded in the financial statements as tangible capital assets, and the related obligations are recorded as other long-term financial liabilities as the assets are being constructed.[16]

In Saskatchewan, a guideline document published by the SaskBuilds Corporation[17] notes that the accounting treatment for P3s will be "open and transparent; [p]romote accountability by providing information to assess the government's use of resources and its financial position; and, [f]ollow the economic nature of the transaction."[18]

In Alberta, the Treasury Board has developed a similar guideline document that directs the responsible ministry to publish a P3 project report within six months after the execution of a P3 agreement, in order to show the general public how value for money is being achieved. In addition, the guideline document indicates that "[t]he accounting treatment [of P3s] is based on the business structure of a specific [P3] project, [and] so it may vary between projects."[19]

In British Columbia, the Office of the Comptroller General developed guidance[20] requiring all P3 contracts to be analyzed on the basis of the substance of the arrangement to determine:

- whether the government controls the special purpose entity;[21]
- whether the public- or the private-sector partner bears the risks and receives the rewards of ownership of the infrastructure asset under development;
- whether the arrangement involves one or more leased infrastructure assets;
- whether any associated leases are considered to be operating or capital in nature;[22] and
- the point at which liabilities are incurred by the government.[23]

Although this information is not disclosed in British Columbia's financial statements, the guidance itself may be of interest in terms of understanding the considerations involved in the financial reporting of P3s.

As another example, Manitoba enacted *The Public-Private Partnerships Transparency and Accountability Act* in 2012.[24] The Act does not define what kinds of projects are suitable for P3s; rather, it outlines rules for public-sector organizations that take part in P3s, with respect to how information is prepared and released about decision-making and how the P3 project is completed. According to Manitoba Finance, "[t]his improves the transparency and accountability of the decision-making process."[25]

4 NEXT STEPS

As governments continue to use P3s to provide public infrastructure, clear accounting standards are needed to ensure certainty, consistency and comparability in the financial reporting of P3s.

In 2008, the Accounting Task Force of the Canadian Council for Public–Private Partnerships issued a position paper that raised a number of issues and made recommendations on ways to improve accounting for P3s.[26] The Council noted that "[t]he [P3] accounting issue is often simplified to the question of whether the [P3] transaction should be on or off the balance sheet of the government."[27] Nevertheless, there is a broad consensus in Canada that P3s should be recorded on the balance sheet of the public-sector partner. The Council recommended that "[P3]-specific guidance should be developed in conjunction with international standards."[28]

In 2014, the Canadian Public Sector Accounting Board included "public-private partnerships" and "service concession arrangements" on its list of possible projects, which indicates that clear and more appropriate standards in relation to P3s may be forthcoming.[29] However, to date, the Board has not announced any projects in relation to these topics and has indicated that it has limited capacity to undertake new projects in 2015–2016.

In its discussion paper entitled *Budgeting and Reporting for Public-Private Partnerships*, the Organisation for Economic Co-operation and Development suggests that "[t]o reduce the bias in favor of [P3s], governments can improve the information that is available about the future fiscal costs and risks of [P3s]."[30] For instance, governments could prepare and publish forecasts of future cash flows in relation to existing and planned P3 contracts; publish P3 contracts; and describe and, where possible, quantify the risks associated with the contracts.

5 CONCLUSION

As support for the use of P3s in Canada at the federal, provincial, territorial and municipal levels continues to grow, clear and appropriate accounting and financial reporting could help Canadians and Parliament to understand the risks and real costs of P3s.

The federal government's audited consolidated financial statements, including its accounting for P3s, meet the requirements of Canadian GAAP. Nevertheless, in terms of getting the full picture, Canadians and parliamentarians could benefit from some additional information related to the structure of federal P3s; the significant risks involved and a quantification of those risks; and any instances of non-compliance in relation to those P3s.

NOTES

1. An overview of public-private partnerships (P3s) can be found in Allison Padova, *Public-Private Partnerships: Why, Where, When, and How*, Publication no. 2010-18-E, Parliamentary Information and Research Service, Library of Parliament, Ottawa, 12 May 2010.

2. Long-term risks that the private sector may be in a better position to manage include construction risks, completion and commissioning risks, life-cycle and residual risks, operations and maintenance risks, and financial risk.

3. A service concession arrangement, or service delivery arrangement, usually involves a private-sector partner providing services to the public on behalf of a public-sector partner. For example, the private sector may collect the tolls on a bridge and administer the resulting funds.

4. PPP Canada, *Identifying P3 Potential: A Guide for Federal Departments & Agencies*, p. 3.

5. Rules-based accounting standards are prescriptive and lead to more consistent treatment of similar transactions, whereas principles-based accounting standards are often subject to interpretation and require that more professional judgment be applied. With rules-based standards, there is a higher risk that contractual arrangements can be designed to circumvent the rules. With principles-based standards, there is perhaps less consistency in how similar transactions are recorded by different reporting entities.

6. The discount rate is the interest rate used to determine the present value of future cash flows.

7. Some P3s are user funded. For example, a private company may use a public asset, such as a bridge, to provide a service that is financed by the users of the asset directly, such as through a toll.

8. Katja Funke, Tim Irwin and Isabel Rial, "Budgeting and Reporting for Public–Private Partnerships," in OECD and International Transport Forum, *Better Regulation of Public-Private Partnerships for Transport Infrastructure*, ITF Round Tables, No. 151, 2013, pp.67–93.

9. United States, Federal Accounting Standards Advisory Board, *Public Private Partnerships*.

10. United States, Federal Accounting Standards Advisory Board, *Public-Private Partnerships: Disclosure Requirements*, p. 29.

11. Ibid., pp. 8–9.

12. According to Receiver General for Canada, *Public Accounts of Canada 2014: Volume I – Summary Report and Consolidated Financial Statements*, 2014 [*Public Accounts of Canada 2014: Volume I*], "[c]apital assets are tangible, durable items of value, including major additions or alterations thereto … from which benefits are expected to be derived during their useful life" (p. 11.3).

13. According to the *Public Accounts of Canada 2014: Volume I*, "[p]urchases are supported by contracts to supply goods or services" (p. 11.3).

14. Ontario Ministry of Finance, "Chapter II: Ontario's Economic Outlook and Fiscal Plan," *2013 Ontario Budget*.

15. Alternative financing and procurement, or AFP, is the term used by the province of Ontario to refer to the use of private-sector partners to procure and finance public infrastructure assets.

16. Ontario Ministry of Finance, *Public Accounts of Ontario 2013–2014*, p. 47.

17. SaskBuilds Corporation, a Crown corporation formed on 17 October 2012 by the Government of Saskatchewan, has the mandate to drive innovation in infrastructure financing, design and delivery, including P3s.

18. SaskBuilds, *SaskBuilds Corporation Public-Private Partnership Project Assessment and Procurement Guideline*, 13 May 2014.

19. Alberta Treasury Board, *Alberta's Public-Private Partnership Framework and Guideline*, 31 March 2011, Appendix A.2, p. 1.

20. British Columbia Office of the Comptroller General [BCOCG], *Practice Guideline 1: Public Private Partnerships*, British Columbia Ministry of Finance, May 2009, p. 7.

21. A special purpose entity, also referred to as a special purpose vehicle or SPV, is a separate purpose-built corporate legal and economic entity. In relation to P3s, an SPV is generally established as a project company and is created for a specific P3 project. This project company is often comprised of a consortium of firms with specific expertise relevant to the project, and typically includes a constructor, an operator or maintenance provider, and an equity provider. The project company would have agreements with lenders that govern its financing and with the public-sector partner sponsoring the project.

22. According to the *Public Accounts of Canada 2014: Volume I*, a capital lease is a lease that, from the point of view of the lessee, transfers substantially all the benefits and risks associated with the ownership of a property to the lessee (p. 1.29). An operating lease is a "lease in which the lessor retains substantially all the benefits and risks of ownership" (p. 1.30).

23. BCOCG (2009), p. 7.

24. Manitoba, *The Public-Private Partnerships Transparency and Accountability Act*, C.C.S.M., c. P245, 14 June 2012.

25. Manitoba Finance, "The Public-Private Partnerships Transparency and Accountability Act."

26. Canadian Council for Public-Private Partnerships, *Public Sector Accounting for Public-Private Partnership Transactions in Canada*, July 2008.

27. Ibid., p. 2.

28. Ibid., p. 10.

29. Public Sector Accounting Board, *2014 Project Identification Survey*, February 2014.

30. Funke, Irwin and Rial (2013).