



# **COMMONWEALTH GRANTS COMMISSION**

**DISCUSSION PAPER CGC 2003/1**

**PRIVATELY FINANCED PROJECTS**

**JANUARY 2003**

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## ISSUES

1. New South Wales has raised the issue of the Commission's treatment of privately financed projects, arguing that:

- (i) the current approach (where the infrastructure expenditure component on such projects might be classified as non-infrastructure related) may provide a disincentive for States to engage in such projects; and
- (ii) the Commission should include both publicly and privately financed and funded roads within the scope of the roads assessment.

2. A further question for the Commission is whether a disability should be assessed for each State's capacity to engage the private sector to finance 'public' infrastructure and be involved in the provision of public services from that infrastructure. At the October Conference, several States argued that they find it difficult to access such arrangements.

3. The Commission's interest in the area is quite specific. It needs to know how such an approach to the provision of public sector infrastructure and services might impact on the adequacy of its assessment framework, and whether that framework might inadvertently distort the financing choices facing States. The questions for the Commission are:

- (i) where a payment stream to a private sector provider includes payment for the use of infrastructure, should the Commission classify the depreciation and debt charges components of the expenditure to the depreciation and debt charges categories?
- (ii) should the Commission include data relating to privately financed and funded roads within the roads assessment?
- (iii) to what extent do States have different abilities to make use of private financing and service provision, and should any such difference be subject to assessment by the Commission?

4. This paper discusses the issues raised for the Commission by the growth of privately financed projects. The Commission has endorsed the paper for distribution and discussion but it will not form a view on the issues until it has received States' rejoinder submissions on 28 February 2003.

## BACKGROUND

### *What are Privately Financed Projects?*

5. A privately financed project is where the private sector provides infrastructure and associated services that could otherwise have been purchased and provided by the government. The asset may be funded through payments by the government or through user charges. The services can extend from cleaning, security and utility expenses to the actual provision of the primary service, such as custodial services in prisons. It is integral to most privately financed projects that the operator designs, builds, finances, and operates a property to provide the contracted service.<sup>1</sup> This distinguishes such arrangements from outsourcing. In the case of publicly funded projects, the payment stream includes the cost of these services as well as depreciation and debt charges expenses.

6. Generally, the decision to procure infrastructure is made according to operational needs. In New South Wales, Victoria and Queensland, once the decision to procure has been made, the government determines whether it should be financed (and perhaps funded) privately or publicly. This decision is based on the achievement of value for money, including appropriate risk transfer, and a public interest test. Value for money is calculated using a public sector comparator which calculates the costs and risks of the public sector completing the project. Private sector bids are compared with this estimate. If the infrastructure is provided under private financing, the relevant department (such as Education) loses the capital allocation it would have received, but may be allowed to keep some or all of the savings achieved. Tenders are called and evaluated. For large projects, a tenderer is likely to be a consortium including financiers, a developer and operators for each aspect of the project (such as security and maintenance). Over the life of the project, the government makes payments to the provider (or user charges fund the project in some cases). At the end of the contract, ownership of the infrastructure may pass to the government.

### *Types of Privately Financed Projects*

7. Privately financed projects are not a new phenomenon in Australia. The most familiar form of this type of government procurement is Build-Own-Operate-Transfer (BOOT). A typical BOOT project involves the private developer financing, building, owning and operating a facility for a specified period. At the expiration of the specified period, ownership of the facility, which may have been built on government-owned land, is transferred to the government.<sup>2</sup> Other types of partnerships include:

- (i) Build-Own-Maintain (BOM) — involves the private sector building, owning and maintaining the facility;

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<sup>1</sup> HOTARAC, Accounting for the Private Provision of Public Infrastructure by Public Sector Entities, Draft Discussion Paper, June 2002, p 23.

<sup>2</sup> Malone, N, States' use of Privately Owned Assets in the Provision of Government Services, Report to the Commonwealth Grants Commission. 30 November 2002, p 5.

- (ii) Build-Own-Operate (BOO) — similar to BOOT but the service provider retains ownership of the asset in perpetuity;
- (iii) Design-Build-Operate (DBO) — a design and construction contract linked to an operation and maintenance contract with the public sector retaining ownership;
- (iv) Lease-Own-Operate (LOO) — an existing asset is leased from the government for a specified time; and
- (v) Divesture — there is a transfer of ownership of the assets to the private sector, which has full responsibility for operations, maintenance and investment. A divesture can be partial or complete, with a complete divesture being privatisation.<sup>3</sup>

8. Privately financed projects transform government agencies from being owners and operators of assets to purchasers of services from the private sector (although they may ultimately assume ownership of the asset). The government however generally retains overall responsibility for the service delivery.<sup>4</sup> In many cases, the private firms become long term providers of the service, combining the responsibilities of designing, building, financing and operating the assets in order to deliver the services demanded by the public sector.<sup>5</sup>

9. Infrastructure can be classified into two categories: economic infrastructure and social infrastructure. **Economic infrastructure**, in which the private sector has been involved for many years, consists of transport and communication facilities, and the production and transmission of electricity, gas and water.<sup>6</sup> Examples include the Australian Synchrotron and the Spencer Street Station redevelopment in Victoria, water infrastructure in New South Wales and the Dalrymple Bay coal terminal in Queensland. **Social infrastructure** is physical infrastructure which aids the provision of social services such as hospitals, schools, police stations, day care centres and prisons.<sup>7</sup> Examples include the Deer Park and Lara prisons in Victoria, Northwest and Central Coast schools in New South Wales, the Parramatta court complex and the Noosa hospital redevelopment.

10. There are a number of payment mechanisms that can be combined or used individually in privately financed projects. They include:

- (i) user charges — direct payments by the users of the infrastructure or service (such as tolls);

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<sup>3</sup> Malone, N, States' use of Privately Owned Assets in the Provision of Government Services. Report to the Commonwealth Grants Commission. 30 November 2002, p 5-6.

<sup>4</sup> Public Private Partnerships: An Introduction. Department of the Parliamentary Library Research Paper, No 1 2002-03.

<sup>5</sup> Millhouse, A, Public Private Partnerships – The Dawn of a New Era for Project Financing? Allens Arthur Robinson, 27 May 2002, p 4.

<sup>6</sup> Private Infrastructure Task Force Report, Economic Planning Advisory Commission, September 1995, p 110.

<sup>7</sup> Private Infrastructure Task Force Report, Economic Planning Advisory Commission, September 1995, p 112.

- (ii) use-based payments — payments from the government that vary according to use of the infrastructure or service; and
- (iii) availability-based payments — payments from the government for making infrastructure and/or services available to a certain standard.<sup>8</sup>

11. Following the trend toward privately financed projects in the United Kingdom (UK), some Australian States are increasing their use of such arrangements. Although privately financed projects have been implemented in one form or another in New South Wales for many years, they still account for less than 10 per cent of the State's capital budget. The movement towards the establishment of guidelines by the States, coupled with the development of standards by authorities, does however demonstrate that partnerships are increasing in significance. Peter Johnson, fund manager for Industry Fund Services, has estimated that over the next five years, up to \$20 billion would be available in debt and equity finance to invest in partnerships.<sup>9</sup> It is expected that privately financed projects will continue to increase but will not overtake traditional public provision of infrastructure and services.

### ***Accounting Treatment***

12. At present, there is no accounting standard for the treatment of privately financed projects. However, efforts are being made to introduce such a standard.

13. ***Heads of Treasuries Working Group.*** To progress the development of appropriate financial reporting requirements for the public sector (in terms of privately financed projects), Heads of Treasuries established a working group in conjunction with the Heads of Treasuries Accounting and Reporting Advisory Committee (HOTARAC) and the private provision of public infrastructure sub-committee.

14. The task of the working group is to develop an approach that could be adopted by the Australian Accounting Standards Board to form an accounting standard. The working group has recommended that Australia adopt the accounting arrangements used in the UK, which are based on a risks and benefits approach (similar to that in other standards such as leasing). The UK is the only jurisdiction that has developed detailed guidance on how to account for privately financed projects.<sup>10</sup> The expected accounting standard is likely to be oriented towards the UK's Financial Reporting Standard, (FRS) 5, with some modifications. Field testing is now being conducted to ensure that the arrangements are appropriate for Australia. The final report will be put to Heads of Treasuries in March 2003.

15. Of particular relevance to the work of the Commission is *Application Note F to UK Accounting Standard Financial Reporting Standard FRS 5 "Reporting the Substance*

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<sup>8</sup> Malone, N, States' use of Privately Owned Assets in the Provision of Government Services. Report to the Commonwealth Grants Commission. 30 November 2002, p 23.

<sup>9</sup> Gray, J, Going Private: a \$20bn shake up, The Australian Financial Review, 11 February 2002, p 52.

<sup>10</sup> Accounting for the Private Provision of Public Infrastructure by Public Sector Entities, HOTARAC Draft Discussion Paper, June 2002, p 3.

*of Transaction: Private Financing Initiative and Similar Contracts.* This specifies that where the purchaser has an asset of the property and a liability to pay for it, the asset should be depreciated over its useful economic life, and an imputed finance charge on the liability should be recorded.

16. Following the UK's lead, it is likely that Australia will adopt an approach based on risks and benefits. For Australian accounting standards, a party is considered to have an asset of the property depending on their access to the benefits of the property and exposure to the associated risks. Although service delivery and ownership may be different under privately financed projects, the risk-benefits approach allows the government (at a given level of benefits and risk exposure) to record the asset on its balance sheet. FRS 5 identified seven key factors (risks) that may provide a significant variation in property profits and losses and can help establish who has control over the property. These are:

- (i) demand risk;
- (ii) the presence, if any, of third-party revenues;
- (iii) who determines the nature of the property (design risk);
- (iv) penalties for under-performance or non-availability;
- (v) potential changes in relevant costs (pricing risk);
- (vi) obsolescence, including the effects of changes in technology; and
- (vii) the arrangements at the end of the contract, and residual value risk.

17. For further information on the accounting treatment of privately financed projects, see Appendix 1.

## **CLASSIFICATION OF EXPENDITURE**

18. How should States' expenditure on privately financed projects be classified by the Commission in the standard budget? Should the depreciation and debt charges components be identified and added to the depreciation and debt charges category standards to which more capital-relevant disabilities are applied? This is an important question for two reasons:

- (i) to avoid the distortion of grant shares; and
- (ii) to ensure policy neutrality.

### ***State Views***

19. This matter has not been the subject of written submissions by most States, but was briefly discussed at the October Conference and in discussions between

Commission staff and the Treasuries of New South Wales, Victoria and Queensland. The views expressed are summarised below.

20. ***New South Wales.*** New South Wales argued that a State's decision to finance privately should not incur a penalty. It put the view that governments should receive the capacity to fund their required levels of infrastructure through the standard policy (implied to be non-private financing) and that the Commission's assessments should not create disincentives to seek more efficient and innovative methods of capital provision.

21. New South Wales records the depreciation and interest charges components of the payment stream as depreciation and debt charges in the State's accounts. Where infrastructure is to be transferred to the government, a right to receive is recorded in government accounts. This grows as the transfer date approaches.

22. ***Victoria.*** Victoria supported the view held by New South Wales.

23. Victoria determines its accounting treatment taking account of issues such as risk transfer and ultimate ownership of the asset. It is modelled on the UK approach.

24. ***Queensland.*** Queensland agreed with New South Wales that the Commission's approach should not be biased towards a particular form of procurement.

25. Queensland's accounting treatment is to be determined on a case by case basis, partly on the basis of the level of control the government exercises over the asset. The Auditor-General will have a role in determining the appropriate treatment.

26. ***Western Australia.*** Western Australia emphasised the importance of the Commission avoiding double counting of capital-related costs.

27. ***South Australia.*** South Australia argued that where a State has not yet purchased the asset, expenditure on privately financed projects should not be recorded in terms of depreciation or debt charges.

28. ***Tasmania.*** Tasmania broadly supported the view of New South Wales and Victoria.

29. ***ACT and the Northern Territory.*** The ACT and the Northern Territory have not yet expressed a view.

### ***Comments***

30. The current approach to classification would result in distorted grant shares where:

- (i) a State has different disability factors for depreciation or debt charges, and relevant categories such as schools or hospitals; and

- (ii) any State includes infrastructure-related expenses in categories such as schools or hospitals (rather than allocating appropriate amounts to depreciation and debt charges).

31. For example, assume that State A has a disability factor of 1.2 for depreciation and 0.8 for government primary schools. If any State classifies all of its payments to a private provider of primary schools as education expenses, then standard expenditure for primary schools would rise (relative to its share if all schools were purchased using traditional procurement methods) and the standard expenditure for depreciation would be lower than it would otherwise have been. Consequently, States A's grant share would be smaller than it would have otherwise been. The size of the change would depend on the State's influence on the standard and on the size of the payment.

32. The second condition may not be met. New South Wales and Victoria have informed Commission staff that they classify appropriate proportions of payment streams as depreciation and debt charges and that this is reflected in government finance statistics. Further, it is likely that Australia will adopt a similar accounting approach to the UK. This would involve the allocation of depreciation, debt charges and operating expenses for those projects (where the government exercises control of the property). If this approach is adopted, then government finance statistics should reflect the depreciation and debt charges expenses of State governments in a standard way. The tests applied to determine which party exercises control of the property should also alleviate the concerns of Western Australia and South Australia about depreciation and debt charges expenses being allocated inappropriately.

33. Where a State is purchasing the use of infrastructure, it is appropriate that asset-related disabilities are applied, rather than disabilities related to such expenses as staffing and utilities. Commission staff support the view that the depreciation and debt charges standards should include the relevant components of payments to private providers (where the criteria for government control of the property have been met). This appears to be consistent with the direction likely to be taken by the Heads of Treasuries working party. There is a counter view that because States are purchasing a service, capital-related disabilities should not be applied. However, because these arrangements relate explicitly to the provision of infrastructure, it is appropriate that they are treated differently from outsourcing arrangements (subject to each project's treatment under the future accounting standard).

34. The Commission's treatment of privately financed projects may also have implications for its approach to the leasing of accommodation. It could be argued that States should record part of their accommodation lease payments as depreciation and debt charges expenses, making this part of the input costs factor obsolete. Against such an approach, it can be argued that:

- (i) the Commission already directly assesses needs for the leasing of accommodation; and
- (ii) it would only be practical if all States chose to record leasing expenses accordingly.

The Commission would welcome the views of States on this matter.

## **TREATMENT OF PRIVATELY FINANCED AND FUNDED ROADS**

35. New South Wales argued that all arterial road stock (including privately owned toll roads) should be included within the scope of the assessment.

36. In the 1999 Review, the length and use of privately financed *and* funded roads were not part of the roads assessment because they had no impact on States' budgets. Privately financed and funded roads are different from roads that are privately owned but publicly funded because these have an impact on State budgets. The later arrangement can be seen as an operating lease. It is similar to the Commission's approach in other categories. For example, privately owned hospitals funded by State governments are included within the scope of the hospitals assessment. However, privately owned hospitals funded through user charges are not included in the hospitals assessment.

37. New South Wales was concerned that policy decisions on who funds the road might have grant share implications. That is, governments can choose whether to fund roads from State finances or directly through user charges. The decision will influence grant shares.

### ***State Views***

38. This matter has not been the subject of written submissions by most States. However, it was briefly discussed at the October 2002 Conference.

39. ***New South Wales.*** New South Wales argued that the decision to undertake a project is made before the decision about how it is financed and funded. New South Wales also referred to the above average revenue burden placed on residents who are required to pay user charges such as tolls. Therefore it supported the inclusion of all roads in the Commission's assessment — road expenditure, revenue, use and length. New South Wales said that tolls collected in respect of road infrastructure, whether by public or private sector agencies, should be included in the standard and the assessment for road user charges.

40. ***Victoria.*** Victoria was not convinced that private infrastructure that is totally funded by tolls or user charges should be taken into account by the Commission.

41. ***Queensland.*** Queensland asked: if one State can levy a toll, does it mean that it has a greater revenue raising capacity than a State that can not levy a toll because of low traffic use.

42. ***Tasmania.*** Tasmania believed that if there were a toll road that was fully self-funding and did not involve any support from the government, it would be a private project and should not be included in the Commission's assessment. This would also apply if the toll road was publicly owned.

43. No other State expressed a view.

### ***Comments***

44. Assuming that the Commission adopts a similar approach to the structure of the roads assessment in the 2004 Review as it did in 1999, should it continue to exclude privately financed roads from road length and road use? Should roads be treated differently according to whether they are funded directly by the government or through user charges? There are four plausible financing-funding combinations that State governments could use for roads:

- (i) publicly financed and funded;
- (ii) privately financed but funded by the government;
- (iii) publicly financed but funded through user charges; or
- (iv) privately financed and funded.

45. The first combination is the traditional approach and presents no difficulties for the Commission's assessment framework as far as this issue is concerned. In the second situation, there is a direct impact on the government's budget. The fact that this expenditure is on an asset that is not owned by the government is irrelevant, so inclusion is again appropriate. Staff believe that the third combination should also be included in the assessment because the tolls are collected directly by the government. However roads that are privately financed and funded should be excluded because there are no financial transactions recorded in the State's budget (no impact).

### ***Conclusion***

46. Commission staff believe that road length and use for those roads financed or funded by governments should be included. However, privately financed and funded roads should be excluded on the basis that there is no impact on State's budgets. States are invited to outline their views on this matter in rejoinder submissions.

## **SCALE DISABILITY**

47. To what extent do the States have different opportunities to make use of privately financed projects, and should any such differences be subject to assessment by the Commission? It is possible that smaller States have fewer opportunities due to less interest from the private sector. They may also face diseconomies of scale in developing expertise.

## *State Views*

48. This matter has not been the subject of written submissions. However, it was discussed at the October conference, the Commission's 2002 Workplace Discussions visit to Tasmania and staff visits to New South Wales, Victoria and Queensland.

49. ***New South Wales.*** New South Wales expressed the view that smaller States should be able to undertake privately financed projects and may find opportunities jointly with other States. New South Wales argued that it has opportunities because it has grasped 'first mover advantage'. Other States could benefit from following its lead.

50. ***Victoria.*** Victoria conveyed the view that the smaller States could use standards and documentation developed by the larger States and the UK. It said the smaller States could form partnerships on smaller projects. In response to the ACT's claim that it is disadvantaged due to the costs of managing the projects, Victoria argued that it too experiences the costs of evaluating proposals and managing projects, but buys in the required expertise.

51. ***Queensland.*** Queensland believed that the circumstances facing States should not be too different and expressed the view that it would consider entering a project with another State.

52. ***Western Australia.*** Western Australia considered itself to be disadvantaged compared to the larger States and cited population dispersion as a hindrance.

53. ***South Australia.*** South Australia said that it is disadvantaged due to its size.

54. ***Tasmania.*** Tasmania said that its efforts to enter into these kinds of transactions have failed, citing the high fixed costs of setting them up as a cause. It also argued that the larger States can generate benefits not available to the smaller States through risk transfer from government to a private owner/operator.

55. ***ACT.*** The ACT said that due to its small population, it was not able to benefit from the private sector provision of infrastructure to the same extent as the larger States. The ACT agreed with Tasmania that, especially with smaller projects, the fixed costs are very high. The ACT also raised the point of smaller States having the added per capita burden of the cost of managing the projects.

56. ***Northern Territory.*** The Northern Territory argued that private sector partnerships are more difficult to access in the Territory due to the lack of a private sector involvement in public sector-type activities. This is generally a result of the Territory's small private sector, its isolation and the lack of any significant industrial base.

## *Comments*

57. Both the private and public sectors of a less populous State may face difficulties in establishing privately financed projects. These potential difficulties mean that the Commission may need:

- (i) to consider whether smaller States face cost disadvantages because of reduced opportunities for such projects; and
- (ii) to reconsider the administrative scale assessment.

The assessment of service delivery scale disabilities will continue to be required because relevant costs will continue to be reflected in payment streams to providers.

58. The relevant questions for the Commission are:

- (i) does the privately funded approach to projects generate savings for governments?
- (ii) are small States disadvantaged in accessing such projects?
- (iii) will such projects result in a net increase (or decrease) in a small State's administrative scale disability?

59. ***Does private funding generate savings for governments?*** This question is important for the Commission because the issue of disabilities only becomes relevant if smaller States are excluded from making expenditure savings that are available to larger States. The Commission is not yet in a position to answer this question. New South Wales has argued that its arrangement to secure schools through private financing will save four per cent compared with the cost of traditional procurement.<sup>11</sup> However, ABN Ambro is reportedly considering establishing a public-private partnership fund that would guarantee double digit returns.<sup>12</sup> Such a guarantee does not make expenditure savings impossible, but it does raise the question of how the savings will be achieved if payment streams cover such high returns on capital.

60. ***Are small States disadvantaged in accessing such projects?*** This would be the case if the size of projects available were too small to attract the private sector (which has some fixed costs per project) or to generate savings. Smaller States, with their smaller 'bundles' of needs and lower throughput for projects such as toll roads, are likely to be less attractive partners. For example, according to GHD Consulting, such arrangements are unlikely to be worthwhile for projects of less than about \$10 million.<sup>13</sup> As New South Wales suggested, smaller States may be able to ameliorate any such disadvantage by undertaking projects jointly with other States. It is also possible that individual project thresholds will reduce in magnitude as more projects become available and a critical mass of projects is created. Participants (governments, financiers and operators) may also see a decline in the marginal cost of administering or submitting tenders as more projects are undertaken.

61. ***Will such projects result in a net increase (or decrease) in a small State's administrative scale disability?*** This depends on whether higher management costs are offset by savings generated from the use of templates, policies and knowledge of larger

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<sup>11</sup> Emerson, S., 'Partnership profits hard to bank on', Weekend Australian, 27-28 July 2002, p. 9.

<sup>12</sup> Allen, L., 'ABN Ambro looks at PPP fund', Australian Financial Review, 15 January 2003, p. 3.

<sup>13</sup> Jay, C, Partnerships the Future for Infrastructure Projects, Australian Financial Review, 8 November 2002, p 68.

States. The disadvantages to smaller States, arising from high transaction costs and from the fixed costs associated with the need to maintain high levels of contract development and management skills, presently recognised in the administrative scale factor, may be ameliorated slightly in the future. This is because a national approach, based largely on the existing and developing policy work of New South Wales, Victoria and Queensland may, in a relatively short time, reduce some costs to the smaller States by removing some needs for policy and guideline development. The use of this approach may, however, also impose higher per capita contract administration costs.

62. In deciding whether to assess a disability for access to private capital and how the administrative scale factor might need to be modified, the Commission would welcome the views of States. In relation to a possible disability relating to access to private capital, it would particularly welcome ideas about how such an assessment could be developed and the evidence on which it could be based.

## CONCLUSIONS

63. Commission staff are mindful that these questions have yet to be discussed comprehensively by the States and look forward to receiving further views in the rejoinder submissions due on 28 February. At this point Commission staff are inclined to take the following positions.

- (i) On the classification of expenses, we believe that depreciation and debt charges expenses should generally be allocated to these categories — we note that this is currently largely the case and intend to monitor developments in this area to ensure the continuing accuracy of the Commission's assessments.
- (ii) The treatment of privately financed *and* funded roads should continue to be excluded from the roads assessment.
- (iii) At this point, we are unable to determine whether a scale disability exists, and how any such disability might be measured.

## ACCOUNTING TREATMENT OF PRIVATELY FINANCED PROJECTS

1. This appendix outlines developments in the accounting treatment of privately financed projects. Currently, there is no accounting standard, so the existing standard on accounting for operating and finance leases has tended to be adopted as a default. It is likely that the UK's approach will be adopted, with some relatively minor variations. As noted in the discussion paper, this would satisfy the Commission's data requirements.

2. ***Heads of Treasuries Working Group.*** The Heads of Treasuries established a working group to develop an approach that could be adopted by the Australian Accounting Standards Board to form an accounting standard. The working group has recommended that Australia adopt the accounting arrangements used in the UK, which are based on a risks and benefits approach (similar to that in other standards such as leasing). The UK is the only jurisdiction that has developed detailed guidance on how to account privately financed projects.<sup>14</sup> The expected accounting standard is likely to be oriented towards the UK's Financial Reporting Standard 5 (with some modifications).

3. Of particular relevance to the work of the Commission is *Application Note F to UK Accounting Standard Financial Reporting Standard FRS 5 "Reporting the Substance of Transaction: Private Financing Initiative and Similar Contracts"*. This specifies that, where the purchaser has an asset of the property and a liability to pay for it, the asset should be depreciated over its useful economic life, and an imputed finance charge on the liability should be recorded.

4. ***United Kingdom Government.*** The Private Finance Initiative concept has gained momentum in the UK over the last decade following the initial Private Finance Initiative in 1992. Since then, over 400 contracts have been completed.<sup>15</sup> Australian States and government bodies have subsequently looked to the UK for guidance when implementing privately financed projects and, with an imminent accounting standard to be developed, it was essential to examine the UK accounting treatment of privately financed projects.

5. Accounting standards relevant to privately financed infrastructure and similar transactions are Financial Reporting Standard 5 (FRS 5), which deals with the substance of the transactions; and the Statement of Standard Accounting Practice 21 (SSAP21), which deals with accounting for leases and hire purchase contracts.

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<sup>14</sup> Accounting for the Private Provision of Public Infrastructure by Public Sector Entities, HOTARAC Draft Discussion Paper, June 2002, p 3.

<sup>15</sup> Gray, J, Going Private: a \$20bn shake up, The Australian Financial Review, 11 February 2002, p 52.

6. Paragraphs F51 and F53 of the application note to the amendment of FRS 5 include provisions for privately financed infrastructure.

F51 'Where it is concluded that the purchaser has an asset of the property and a liability to pay for it, these should be recorded on the balance sheet. The initial amount recorded for each should be the fair value of the property. Subsequently, the asset should be depreciated over its useful economic life and the liability should be reduced as payments for the property are made. In addition, an imputed finance charge on the liability should be recorded in subsequent years using a property-specific rate (paragraph F16 discusses how to determine such a rate). The remainder of the PFI payments (i.e. the full payments, less the capital repayment and the imputed financing charge) should be recorded as an operating cost. If the purchaser has any other obligations in relation to the PFI contract, these should be accounted for in accordance with FRS 12 'Provisions, Contingent Liabilities and Contingent Assets.'

F53 'Where it is concluded that the purchaser does not have an asset of the property, there may nevertheless be other assets or liabilities that require recognition. These can arise in respect to contributions, acquisition of the residual and other obligations of the purchaser.'

7. **Australian Accounting Standards Board.** The Accounting Standards Board had undertaken some preliminary work in this area. It is now providing tacit endorsement to the HOTARAC project. It is also involved in a research project on 'Accounting for Service Concession Arrangements' set up by the International Accounting Standards Board.

8. **Australian Bureau of Statistics.** The Australian Bureau of Statistics (ABS) currently bases its statistical treatment of privately financed projects on the UN System of National Accounts 1993 SNA93 and on Eurostat. The ABS has been focusing on BOOT schemes in its treatment of privately financed projects. SNA93 does not have a treatment for BOOT schemes, therefore the ABS currently follows the Eurostat treatment. The Eurostat treatment of BOOT schemes focuses on the ownership of the asset and on who bears the risk and rewards of the transaction.

9. At a recent internal meeting, the ABS noted that its current interpretation of SNA93 corresponds to current data collections and accounting standards. The ABS has advised us that it would pursue, via an international forum, any future changes to its standards, and would not make any major changes to the way it approaches privately financed projects until internationally acceptable standards emerge. It did however agree to provide additional information on privately financed projects in its statistics, outside the international accounting framework.

10. The ABS has not made any adjustments to the reporting adopted by individual jurisdictions.<sup>16</sup>

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<sup>16</sup> Accounting for the Private Provision of Public Infrastructure by Public Sector Entities, HOTARAC Draft Discussion Paper, June 2002, p 22.

11. ***Auditors-General.*** The Australasian Council of Auditors-General has considered the HOTARAC report. It is generally supportive of the report and has submitted comments to HOTARAC for consideration.<sup>17</sup>

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<sup>17</sup> Conversation with the NSW Auditor General Office, 8 January 2003.