School of Business and Management

Accounting for PFI and asset infrastructure risk: The case of the Greater Manchester Waste Authority

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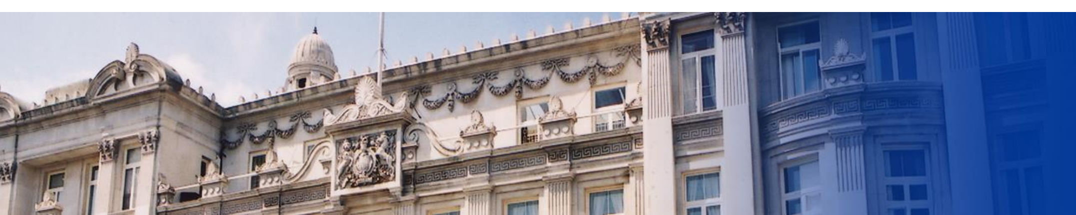

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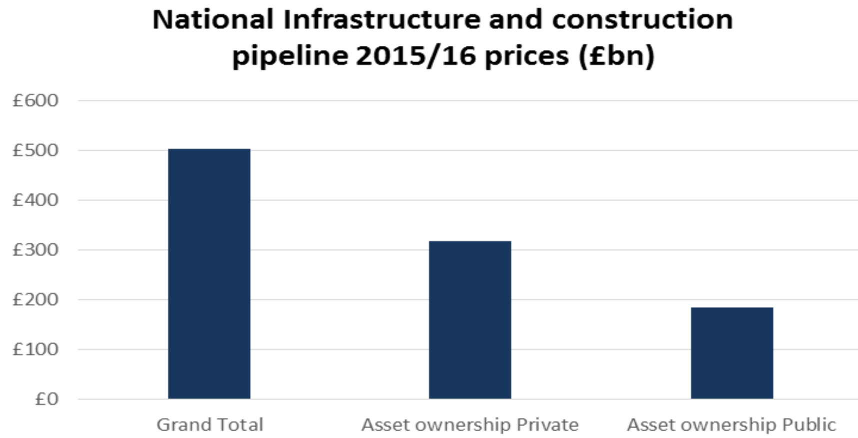
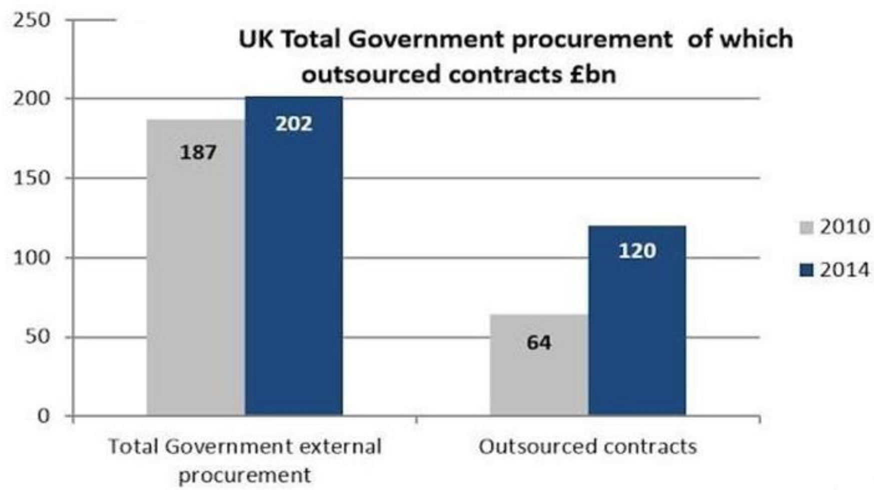
Introduction

- The UK treasury forecast for future national infrastructure spend is £502bn.
- Of this ~£200bn will be treated as public sector assets.
- Public sector reporting entities account for these assets on balance sheet because these assets are attached to outsourcing service concession contracts.





PFI as risk transfer to private sector

- Incentives / penalties in contracts would transfer risk from public to private sector.
- Delivery of infrastructure assets that might be difficult to finance conventionally
- Encourage private sector industry capacity
- Private sector efficiency would deliver projects on time
- Private providers encouraged to maintain infrastructure assets

Accounting for PFI and infrastructure assets

- The adoption of international financial accounting recommendations determines whether PFI infrastructure assets are attached to the provision of ‘service concession agreements’
    - Where the public sector control/ regulates what services the operator must provide with the infrastructure or has any significant residual interest in the infrastructure at the end of the term of the arrangement

- These infrastructure assets and their corresponding liabilities (how assets have been funded) are recorded on the public sector reporting entities accounts.
    - Standard PFI schemes are service concessions within the scope of IFRIC 12 and public sector accounting rules state that public bodies must recognise the infrastructure (together with the related liability to pay for it) on their balance sheets from the date the services commence
        - IFRIC (International Financial Reporting Standards Interpretations Committee)

PFI and Infrastructure Asset Risk

- Not only are public sector reporting entities required to ‘bring back’ infrastructure assets and associated liabilities back on to their balance sheets

- BUT…..These tangible assets are also subject to periodic ‘fair value assessments’ following international accounting standards with IFRS 13 Fair Value Measurement

- Technically these assets are not cash generative for the public-sector reporting entity but they are subject to periodic impairment tests.

- The risk is that they could be impaired.

- The adoption of IFRS accounting standards for infrastructure attached to ‘service concession agreements’ not only brings back asset values on to a public sector reporting entity balance sheet but IFRS 13 imports fair value asset impairment risks.

Greater Manchester Waste Authority

- The Greater Manchester Waste Disposal Authority GMWDA is the largest of six statutory waste disposal authorities created under the UK Local Government Act (1985).

- According to the latest final report and accounts: GMWDA is England’s biggest waste disposal authority and deals with over 1 million tonnes of waste each year and is equivalent roughly 4% of England’s local authority collected waste (LACW).

- The annual report and accounts also recognise that GMWDA controls the services provided under the Recycling and Waste Management Contract with Viridor Laing (Greater Manchester) Ltd and entitled to the residual value of the facilities at the end of the contract.

- This means that GMWDA reports the value of infrastructure property, plant and equipment and financial liabilities attached to its PFI outsourcing contract with Viridor on its balance sheet.

GMWDA: Summary of Key Financial Metrics

£ mill	Property plant and equipment net of impairments	Long-term Liabilities	Net Assets	Accumulated asset impairments	Funds from household Levy
As at 2016	258.7	368.5	-115	-208.1	164

- As at March 2016 asset impairments of £208 million had reduced the value of infrastructure assets to a level below that of long-term liabilities (borrowings and PFI leaser obligations)
- As at March 2016 Impairments to infrastructure asset values exceeded one years worth of household levy
- As at March 2016 GMWDA was running with negative net worth

Public sector financial risk from infrastructure assets

- Public sector reporting entities are required to bring assets and liabilities on balance sheet where they are attached to 'service concession agreements'

- The adoption of IFRS accounting standards subjects infrastructure assets to periodic value impairment tests.

- This brings financial risk on to public sector reporting entity balance sheets

- Asset impairments have the potential to run ahead of outstanding liabilities forcing public sector reporting entities into negative net worth.

- Repairing the balance sheet at GMWDA will be difficult. Increasing the household levy a political challenge…Negotiating savings with the private provider will involve further investment which GMWDA cannot easily fund when its balance sheet is so weak.