10 February 2012

Our ref: ICAEW Rep 11/12

PPP Policy team
2/S1
HM Treasury
1 Horse Guards Road
London SW1A 2HQ

By email PFIevidence@hmtreasury.gsi.gov.uk

Dear sirs

Reform of the Private Finance Initiative

ICAEW welcomes the opportunity to comment on the call for evidence *Reform of the Private Finance Initiative* published by HM Treasury on 1 December 2011, a copy of which is available from this link.

ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter which obliges us to work in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 136,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

This response draws on views from ICAEW's wider membership as well as members of ICAEW's Corporate Finance Faculty, a network of some 6,000 corporate finance professionals. They include advisers on infrastructure projects, accountants, lawyers and bankers. In 2006, the faculty published for its members a good practice guideline on the Private Finance Initiative, a PDF copy of which is submitted with this response.

By way of information, ICAEW members in Wales have also actively engaged with the Welsh Government on all business issues including consultations on the use of private finance in public capital projects.

We welcome HM Treasury's commitment to improve the approach to using the private sector in the delivery of public assets and services and believe the UK should continue to lead in the use of innovative delivery models. ICAEW is a strong proponent of a responsible private sector role in the future delivery of public infrastructure projects that offer value for money. PFI can be an appropriate public sector procurement tool and we also recognise the potential for stimulating growth and job creation in small and medium enterprises (SMEs) that form part of PFI supply chains.

The Institute of Chartered Accountants in England and Wales
Chartered Accountants' Hall
Moorgate Place London EC2R 6EA UK
icaew.com

T +44 (0)20 7920 8100
F +44 (0)20 7920 0547
DX 877 London/City

We have made some comments in Section 1 of the response template and have chosen to highlight in the Appendix to this letter the issues that we consider to be fundamental to the debate on reforms to the PFI.

These issues address:

- transparency of infrastructure policy objectives;
- capability and skills; and
- the evaluation of the PFI's role in delivering public infrastructure.

We believe that there is a need for a fair and balanced debate as well as education of the media and public to ensure that they understand PFI.

We also take this opportunity to urge the government to ensure that UK infrastructure projects attract the best skills and remain an attractive investment proposition for UK and non-UK investors.

Yours faithfully

Katerina Joannou
Manager, Capital Markets Policy
Corporate Finance Faculty

T +44 (0) 20 7920 8806
E katerina.joannou@icaew.com

APPENDIX

Transparency of infrastructure policy objectives

1. We believe that greater attention is needed in communicating the policy objectives for capital investment, how the impact of changes to policy is assessed and how the changes themselves are implemented. This will ensure a clearer link between policy objectives and plan.

2. Transparent policy objectives will help determine the infrastructure plan (and pipeline) as well as issues designed to attract potential investors such as clarity of sector focus and certainty regarding the treatment of investors (eg planned claw backs or windfall taxes). The decision on what is needed must be in place before procurement decisions, such as budgetary constraints and procurement route (whether PFI, conventional procurement or another), are made.

3. Politicisation may be an inherent feature of major capital projects but electoral cycles lead to instability. In our view this is not sufficiently acknowledged and addressed by successive governments and there would be merit in exploring how political agreement on capital projects is achieved in jurisdictions such as Canada and Australia.

4. An unstable political transition erodes flexibility and efficiency – both major benefits of the PFI model – while increasing the funder's risk premium and thus the cost to the public sector. The fact that the skills and the capital required for these types of arrangements are potentially highly mobile and can move to markets where returns are more attractive and/or more certain also strengthens the case for transparent policy objectives and stability of model and pipeline.

5. Examples where change of policy has frustrated capital projects planned to be funded using PFI include:

    - a variety of health LIFT projects stalled due to organisational and financial uncertainty in the NHS;

    - the Building Schools for the Future initiative where, once the supply chain was in place to progress a pipeline of new build and refurb school building projects, the policy changed despite the continuing need to invest in school buildings;

    - cancellation of most of the £1.8bn "Wave 6" social housing PFI programme; and

    - Ministry of Justice cancelling projects in the prisons and courts sector at the preferred bidder stage due to financial uncertainty.

6. Uncertainty about policy is undesirable for both the public and private sectors. Increased risk perceived by the latter invariably translates as greater cost to the public sector. It also hinders scrutiny of (and accountability for) changes to policy and undermines the attractiveness of the investment proposition.

7. Now that Whole of Government Accounts have begun to be published, we hope and expect that the information on PFI contracts, including assets, liabilities, service costs and interest costs, as well as future commitments, can be explained more clearly and managed more holistically over time than when the focus was, most unhelpfully, only on whether the amounts due under PFI contracts were included in the statistical national accounts or not. The improvement in information (see for example Note 31 of WGA for 2009/10 on PFI commitments) should be valuable in helping government to manage the long-term aspects of PFI by focussing on both the asset and liability element of the contracts and the whole life costs, in the context of a more complete picture of the public sector. As WGA are produced for subsequent periods, this should also allow a picture of PFI to be developed over time.

Capability and skills

8. Capability and skills cover financial and project management and project leadership. The absence of capability and skills was observed in PFI projects such as the Highway Agency's project to widen the M25 and the Future Strategic Tanker Aircraft[1] while frequent changes of staff and inadequate programme management contributed to procurement delays in the Colchester Garrison project and the Housing PFI programme[2] respectively. Such examples render it crucial that the public sector is capable of managing PFI contracts from inception to implementation.

9. We would like to highlight skills to which greater attention should be paid to, and provision made for, within the public sector. These are:

   - the ability to build models to allow realistic comparisons of through life (or whole life) costing of the building and maintenance of public assets under different procurement routes, ie good financial management;

   - development and safeguarding of corporate memory, for example by recruiting experienced staff and retaining them post construction so that lessons are learned in contract negotiation, deal structuring and so on;

   - better documentation discipline for a clear trail of major decisions and issues; and

   - enhanced contract management during the operational phase.

10. We support the principle behind the proposed UK Government Major Projects Leadership Academy (MPLA), to be established in conjunction with Saïd Business School at the University of Oxford, as well as its intended focus on 'building expertise to ensure that future projects meet their objectives on time and on budget, providing the desired outcome, and representing value for money for taxpayers'[3].

11. ICAEW is working on a project which considers the financial capabilities required for successful set up and delivery of a PPP programme from the start, ie at feasibility stage, through to the end of the 20 or 30 year period, for both the public sector and private sector. ICAEW's interest is skills development on a global basis, and this would include:

    - the skills of individuals;

    - the skills of teams within organisations

    - sector wide skills; and

    - the financial frameworks in place.

12. Our view is that for the success of future PFI or other procurement options, it is imperative that the right processes and skills are in place throughout the lifetime of the project. ICAEW would be pleased to discuss this aspect of our work with HM Treasury in more detail if this would be helpful, in particular as we understand that the MPLA 'will not seek to teach project management methodologies'[4]. Please contact sumita.shah@icaew.com, 020 7920 8516.

---

[1] 2011 NAO report http://www.nao.org.uk/idoc.ashx?docId=424B45AD-8B0B-4790-AA5C-5AD856627478&version=-1
[2] 2010 NAO study http://www.nao.org.uk/publications/1011/pfi_in_housing.aspx
[3] http://www.sbs.ox.ac.uk/newsandevents/news/Pages/MPLA.aspx
[4] As reported in Civil Service World, 1 December 2011

13. By way of information, ICAEW has a keen interest in, and promotes recognition of, excellence in financial management in the civil service. To illustrate this, in 2011 the Department for Transport Spending Review Directorate was awarded the Financial Management Award at the Civil Service Awards sponsored by ICAEW.

Evaluation of PFI

14. Private finance should only be used if it is expected to offer better value for money in the delivery of public services than public finance. The assessment of value for money typically takes the form of an equation where the benefits of private sector management (timely delivery and control of costs), risk transfer and innovation should exceed the additional cost of private finance.

15. We observe that often PFI projects are evaluated by reference to non-PFI specific criteria which can result in unfair criticisms. Criteria that are not relevant to the evaluation of PFI include:

   - Accounting treatment and whether PFI assets and associated debt are reported on or off-balance sheet. ICAEW believes that on balance sheet treatment is more transparent and helps shift public sector focus from reducing level of exposures to one that encourages proper judgements when managing PFI projects. In this respect ICAEW supports the WGA and Clear Line of Sight (CLOS) approaches.

   - Assets rendered wholly or partly unwanted due to changes in public policy: the private sector cannot tolerate demand risk for public infrastructure in most circumstances where this is dependent on a variety of public policy decisions which rightly rest with government.

   - The relative costs of raising debt by the public and private sectors when the additional cost of private finance compared to sovereign borrowing is already factored into the PFI value equation as shown in paragraph 14.

16. One issue the Government should carefully consider is how to rehabilitate the public face of the PFI. There is a perception in some quarters that infrastructure projects provide a pipeline of projects that result in excessive returns. Cases such as the refinancing of early hospital PFI schemes where the private sector was deemed to have made excessive profits (eg Norfolk and Norwich NHS PFI), contribute to this negative perception.

17. On the other hand we observe that excessive transfer of risk could itself be better publicised by way of examples where the private sector is understood to have lost money, eg Sir Robert McAlpine[5] and Amec[6], or run into trouble, eg John Laing, even to the extent of insolvency, as in the case of Jarvis. It is important that the private sector operators remain viable in order to maintain assets and deliver services over PFI contracts, so the extent of risk transfer must be only that which the private sector can tolerate while delivering value for money, and they must be allowed to make a reasonable return for the risk they do take on.

18. Importantly, there are contracts where this balance has been, and continues to be, achieved. For example, the 2010 National Audit Office report on Health PFI concluded 'We found that most PFI hospital contracts are well managed. And the low level of deductions and high levels of satisfaction indicate they are currently achieving the value for money expected at the point the contracts were signed'[7].

---

[5] Reported in The PFI Contract in Action—HC 209 Session 2004-05 10 February 2005

[6] http://www.building.co.uk/news/amec%E2%80%99s-losses-on-a13-road-contract-put-at-%C2%A39m/3073660.article

[7] Report by C&AG HC68, 2010-11, 17 June 2010