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Budgeting and reporting for public-private partnerships


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Budgeting and Reporting for Public-Private Partnerships

Discussion Paper No. 2013-7

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March 2013

1 The views expressed herein are those of the authors and should not be attributed to the IMF, its Executive Board, or its management. The authors are grateful for advice and comments from Richard Allen, Ben Clements, Sagé De Clerk, Renaud Duplay, Richard Hughes, Kris Kaufmann, Florence Kuteesa, Chita Marzan, Jason Loos, Delphine Moretti, Kamlesh Patel, Stephen Perkins, Gerd Schwartz, and Johan Seiwald, as well as the participants in the International Transport Forum, September 27–28, 2012. Further comments are welcome. The authors can be reached at kfunke@imf.org, tirwin@imf.org, and irial@imf.org.
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Washington, D.C., March 2013
Summary

1. Public-private partnerships (PPPs) can appeal to governments because they offer a new way of providing public services that is possibly more efficient than traditional public finance. But they can also appeal to governments because they allow new investments to be undertaken without any immediate increase in reported government spending or debt. This second motive for using PPPs rests largely on an illusion, because in the absence of efficiency gains (which are probably small relative to the total cost of the project), PPPs and publicly financed projects have a similar long-run effect on public finances. In some PPPs, the government defers payment, but ultimately must still pay the full cost of the project. In others, it concedes the right to collect user fees, and thus loses revenue it would have collected if the project had been financed traditionally.

2. The attraction of PPPs as a way of getting investment financed without immediately increasing reported spending and debt is closely related to the way that governments measure their spending and their debt. Typically, a government records spending on a publicly financed project when the project is under construction and the government is disbursing cash to, or being invoiced by, the contractor. Any spending on a PPP, by contrast, is usually recorded only when construction is complete and is usually spread out over as many as 30 years. Similarly, if the government borrows in traditional ways to fund the payments it makes during the construction of a publicly financed project, it must record an increase in its debt. But if it assumes an obligation to make payments to the PPP company over the life of the contract—an obligation that has fiscal implications similar to those created by traditional borrowing—it can usually avoid recording any increase in debt in the short run. This encourages a government under pressure to reduce its deficit or debt in the short run to use a PPP even if, in the long run, the PPP costs more than public financing. This bias in favor of PPPs can also lead governments to assume financial commitments that later prove unaffordable.

3. To reduce the bias in favor of PPPs, governments can improve the information that is available about the future fiscal costs and risks of PPPs. They can prepare and publish forecasts of future cash flows under existing and planned PPP contracts and ensure those forecasts are incorporated in medium- and long-term fiscal projections and analyses of debt sustainability. They can also publish PPP contracts and describe and, where possible, quantify the fiscal risks the contracts create. More challenging, but potentially more influential, is to change the way PPPs affect reported spending and debt in the short run. This is increasingly done in accrual-based fiscal data, which often treat PPPs as government projects, even though from a legal perspective they are undertaken by a private company. This means that the government treats investment in the PPP project as public investment and records the PPP asset on its own balance sheet, along with a corresponding liability.
4. But governments often measure their debt and deficit in more than one way, and if there is no change in the most prominent (“headline”) indicators of the debt and deficit, the bias will probably remain. The most prominent indicators are usually those used in setting fiscal rules or fiscal targets, so eliminating the bias requires ensuring that these treat investment in PPPs as public investment that creates both public assets and public liabilities. The consequences of the bias can be limited by imposing specific limits on the size of the PPP program.

5. Removing the bias also requires changes in budgeting. One option is a medium-term budget framework that treats PPPs in the same way as publicly financed projects and therefore ensures that PPPs require the same approvals in the budget and budget plans as publicly financed investments. Another is commitment budgeting, in which the legislature approves not only the government’s cash expenditure in the budget year but also its commitments to spend money in later years. And a third is a two-stage budgeting process, in which all projects must first be approved in budget planning on the assumption that they will be publicly financed, and only then is a decision made about the method of financing projects deemed affordable in the first stage.

I. Introduction

A. What are PPPs?

6. In PPPs, private firms invest in infrastructure used to provide services typically considered public. More specifically, PPPs, as we use the term, are long-term contracts between the government and a private contractor in which the contractor agrees, at its own cost, to build, operate, and maintain an asset in order to provide a service for which the government remains accountable; in return the government promises either to pay for the service or to allow the contractor to collect fees from users. PPPs thus include projects in which the government itself provides the contractor’s revenue (government-funded PPPs) as well as concessions in which users are expected to be the main source of its revenue (user-funded PPPs), even if the government provides additional support in the form of subsidies and guarantees, including guarantees implicit in termination clauses. But PPPs exclude simple joint ventures and arrangements in which the contractor is not required to finance investment.

7. Although PPPs involve the contracting out of construction, maintenance, and operations, it is not this that defines them: in a publicly financed project, all these activities can be undertaken by private firms. What defines a PPP is that the government writes a contract with a single firm (usually a special-purpose company) that agrees to provide the service. That firm typically writes its own subcontracts with construction and operating

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2 There are other definitions. For example, Eurostat (2012) distinguishes PPPs from user-funded concessions.
companies (Figure 1). The use of a PPP contract thus allows the government to concentrate on specifying the services that should be provided, while delegating to its contractor the task of providing the services at minimum cost. Because the PPP contract usually lasts for most of the economic life of the asset, the government can give the contractor incentives to minimize the lifetime cost of the project.

Figure 1. PPPs Versus Public Financing with Contracting Out

8. **PPPs, in this sense, are not new, but their popularity has increased since the 1990s.** In the 1800s, many railways were built under concessions that guaranteed private investors a minimum rate of return. In the 1960s and 1970s, concessions were used to finance investments in French and Spanish highways. But the use of PPPs increased in the 1990s and 2000s, partly with the development in the United Kingdom of PPPs in which the government was the main purchaser of the project’s services (in our terminology, government-funded PPPs). By now, most governments have used some kind of PPP, attracted by the prospect of greater efficiency and of developing new infrastructure without having to report an immediate increase in their debt or deficit. ³

9. **Fiscal Implications of PPPs**

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³ For older PPPs, see Gómez-Ibáñez and Meyer (1993, ch. 8), Grimey and Lewis (2004, ch. 3), and Irwin (2007, ch. 2). Grimsey and Lewis also discuss the new PPPs in the UK. Data on the use of PPPs and similar arrangement in developing countries can be found at www.ppi.worldbank.org.
projects, one government-funded and one user-funded, in which possible efficiency gains (or losses) are ignored and in which there are no costs of operations and maintenance.

- In a government-funded PPP (panel (a)), the government can agree to make payments only when the service is provided and only to the extent that the service conforms to the specifications of the contract. Its payments are therefore deferred. But the contractor will agree to pay for the construction of the asset only if the government agrees ultimately to pay enough to cover the expected costs of construction. Thus, the government’s payments are deferred, not reduced. Under the assumptions of this stylized example, they are the same in present values as those that the government makes under a publicly financed project.

- In the simplest kind of user-funded concession in which user fees exactly cover project costs (panel (b)), the government does not need to make any payments at all. But nor does it receive any revenue. So the net present value of its cash flows from the project is zero. If instead the government uses traditional public financing, it pays for the construction of the project, but later it collects the user fees, which by assumption cover the costs. Again, the net present value of its cash flows from the project is zero. In other cases, the concession may require subsidies or may generate user fees that more than cover costs, but given the simplifying assumptions of this example, the net present value of the government’s payments will still be unaffected by whether it undertakes the project as a PPP or with traditional public finance.

![Figure 2. Stylized Government Cash Flows for Ten Years with a PPP and Traditional Public Finance](image-url)
10. If the use of a PPP instead of public financing does not change the net present value of the government’s cash flows, the PPP does not make investment more affordable. If the government cannot afford to finance the project using traditional public finance, it probably cannot afford to undertake it as a PPP. Conversely, if the government can afford to undertake the project as a PPP, it can probably also afford to finance it traditionally.

11. In reality, the net present value of the government’s cash flows may differ according to whether the project is undertaken as a PPP or with traditional public finance. For example, the use of a PPP could be associated with higher user fees than would be charged under public financing. Alternatively, the change in the structure of contracting shown in Figure 1 could lead to better management and lower costs under the PPP. Because PPPs can commit the government to a course of action for twenty or more years, it is usually thought that a PPP is more likely to save the government money when the government can predict the services it will need over the long run and can specify those services precisely; when the government is likely to change its mind in a few years, or cannot specify the desired service precisely, a PPP may lead to frequent and costly renegotiations. By contrast, when the government finances the project itself, it can change its mind without having to renegotiate any long-term contracts.

12. Although evidence on the differences in the net present costs of PPPs and comparable publicly financed investments is scarce, the differences may be small. The intrinsic differences between a PPP and a publicly financed project are subtle, as is apparent in Figure 1. So in the absence of inefficiencies in contracting that affect publicly financed investments but not PPPs, or vice versa, any differences in the net present values of the government’s cash flows under the two approaches are unlikely to be large. It is true that PPPs sometimes end up costing the government significantly more than was forecast, but the same also appears to be true of traditionally financed infrastructure projects. In both cases, forecasts often seem to be afflicted by optimism or opportunism. Partly because it is difficult to create experiments that can be used to compare the costs of the two approaches, there is little robust empirical evidence on the subject.

C. The Bias in Favor of PPPs

13. Even if the use of a PPP instead of traditional public financing does not reduce a project’s net present cost to the government by much, the difference in the timing of the cash flows can create a strong bias in favor of using a PPP. PPPs can seem much more affordable even if they are not. In most countries, budgets, accounts, and statistics record the cash receipts and payments of the government (and define the government to exclude privately owned PPP companies). At the same time, governments are typically held accountable not for the effect of their policies on the health of public finances over the long

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4 See, for example, Shaoul, Stafford, and Stapleton (2012).
run, but for the deficits and debts that they report during their term in office. When
governments want to reduce the deficit in the short term, PPPs can therefore seem attractive
irrespective of whether they are affordable and cheaper than publicly financed projects. Even
when governments adopt relatively advanced procedures for budgets, accounts, and statistics,
the bias may remain. The sophisticated rules that govern measurement of the fiscal deficit in
the European Union, for example, have allowed European governments to undertake many
PPPs without increasing their deficits until the governments start to make payments, which,
when the contract is signed, may be several years in the future. This problem is not unique to
PPPs; even publicly financed projects may not require any payments in the year in which the
construction contract is signed. But the fact that PPPs distribute the government’s payments
(or the opportunity costs in the case of user-funded PPPs) over as many as 30 years can create
a strong bias in their favor.

14. **PPPs create fiscal costs or risks that are sometimes significant.** In some countries,
the government’s annual payments under government-funded PPP contracts amount to more
than ½ a percent of GDP. In developing countries, user-funded PPPs are sometimes used for
projects that are very large in relation to the government’s limited resources. The hope in
these cases is that the cost of the project will later be recouped from consumers, but the
government (that is, the taxpayer) often bears the risk that revenue proves insufficient. As
with other contingent or nontraditional liabilities, the fiscal obligations created by PPPs need
to be assessed and reported.6

15. **This note sets out three ways in which governments can seek to reduce the bias in
favor of PPPs and to ensure that PPPs, when used, are affordable.**7 The first set of options
aims to improve the information available about the fiscal implications of PPPs (Section II).
The second set aims to improve the way budgeting deals with those fiscal implications
(Section III). And the third set aims to improve the way fiscal rules control the fiscal
implications (Section IV).

II. **Accounting for and Reporting PPP Transactions**

16. **The way PPP transactions are accounted for and reported in the government’s
accounts is an important factor contributing to the bias in favor of using PPPs.** Countries
with pure cash accounting and reporting may underestimate fiscal costs and risks from PPP
transactions, particularly during the construction of the related asset. In this case, the main
fiscal aggregates—fiscal deficit and debt—do not fairly portray the level of risk undertaken
by the government. On the other hand, countries with more sophisticated accounting and

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6 On reporting contingent liabilities and, more generally, making public finance transparent, see IMF (2012).
7 For earlier discussions of related issues, see Hemming and others (2006), Schwartz, Corbacho, and Funke (2008), and World Bank (2012, section 2.4). For more general discussions of PPPs, see, for example, Delmon (2011), Engel, Fischer, and Galetovic (2008), and Grimsey and Lewis (2004). For useful guidelines on PPP policy, see OECD (2012).
reporting standards may be less exposed to the PPP bias, since the latter—even though country specific—normally require PPPs to be accounted for in a similar way to publicly financed projects.

17. Since reporting and accounting for PPPs is country specific, so is the capacity to avoid the bias in favor of them. Some governments follow standards that put most PPPs on their balance sheets. For example, governments in Australia and the United Kingdom follow accounting standards based on *International Financial Reporting Standards* and recognize typical government-funded PPPs on their accounting balance sheets. International Financial Reporting Standards contain an interpretation (*International Financial Reporting Interpretation Committee 12—Service Concession Arrangements*) that applies to companies, not governments, but because it has caused PPP contractors not to recognize the physical assets created by PPPs on their balance sheets, it suggests that these assets should be recognized on the balance sheets of governments. But most governments do not currently recognize PPPs on their balance sheets or treat investment in PPPs as public investment in fiscal data. Some present fiscal data only on a cash basis and do not have a balance sheet prepared according to any particular standard. Other governments apply accrual or partial-accrual standards that treat most PPPs as off balance sheet. In Europe, for example, the statistics underlying the main measures of debt and deficit have this effect.

18. For the sake of concreteness and cross-country comparison we focus our analysis on two international standards. For accounting purposes we refer to the *International Public Sector Accounting Standards* (IPSAS), which are similar to International Financial Reporting Standards but are adapted to governments; while for reporting purposes we refer to the IMF’s *Government Finance Statistics Manual 2001* (updated GFSM 2001, November 2012 draft) and the *2011 Guide on Public Sector Debt Statistics* (PSDS 2011). First we describe current international accounting standards for PPPs and summarize how they affect the two main fiscal aggregates—deficit and debt—and thus the PPP bias. Second, we describe international statistical standards and compare them to the accounting standards. We then briefly discuss the implications of not following these standards in terms of reducing the PPP bias. We finally recommend alternative ways for countries to strengthen accounting and reporting of PPPs transactions to remove or reduce the PPP bias.

A. International Public Sector Accounting Standards (IPSAS) for PPPs

19. The recently issued accounting standard *IPSAS 32, Service Concession Arrangements: Grantor* provides a framework for accounting for and reporting PPP transactions in a government’s accounts that reduces significantly the bias in favor of PPPs. Under IPSAS 32, which is similar in approach to *International Financial Reporting Standards*, PPPs are accounted for in a way that reduces the PPP bias. The interpretation of the service concession arrangement requires that the PPP be accounted for on the balance sheet of the grantor, which is typically the government. This approach is consistent with the principles of IPSAS and ensures that the fiscal impact of PPPs is properly reflected in the government’s financial statements.

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Interpretation Committee 12—Service Concession Arrangements, when certain conditions are met, the impact of a PPP on the main fiscal aggregates is similar to that of publicly financed projects. Under these rules, debt and overall deficit indicators\(^9\) will both increase as the PPP asset is constructed. This is a major improvement in government accountability, since it prevents PPP-related assets and corresponding liabilities from being treated off government’s balance sheet.

20. **IPSAS 32 covers both government-funded and user-funded PPP contracts.** A service concession arrangement is defined as a binding contract between a grantor (the government) and an operator (private sector contractor) in which: (i) the operator uses a public asset (the service concession asset in IPSAS language, for example a highway) to provide a public service for a specified period of time on behalf of the grantor; and (ii) the operator is compensated for its services over the period of the service concession arrangement. Thus, both government-funded and user-funded PPP contracts, as previously defined, are covered by this standard. However, arrangements outside the scope of IPSAS 32 include those where there is no delivery of public services, and where the asset is not controlled by the government (e.g., outsourcing, service contracts, and privatization).\(^10\)

21. **It is expected that under IPSAS 32 most PPP contracts would result in assets and liabilities being regarded as belonging to the government.** According to this standard, the government recognizes an asset and a liability (with the corresponding flows) in its financial statements when the following conditions are met: (i) the grantor controls or regulates what services the operator must provide with the asset, to whom it must provide them, and at what price; and (ii) the grantor controls—through ownership, beneficial entitlement or otherwise—any significant residual interest in the asset at the end of the term of the arrangement. Experience suggests that most PPP contracts would comply with these conditions.

22. **If IPSAS 32 conditions are met, both the overall deficit and debt would be affected during the construction of a PPP asset, as in the case of a publicly financed project.** As detailed in Table 1, if the government compensates the operator by making a predetermined series of payments during the life of the PPP (a government-funded PPP), it recognizes a liability equal to the full value of the asset (transaction 1 in Table 1). Similarly, if the government grants the operator the right to earn revenues from users (a user-funded PPP), the value of the liability recognized equals the full value of the asset. In both cases, the counterpart entry for the increase in the government’s liabilities is the net acquisition of a nonfinancial asset, which increases the overall deficit—that is, a measure of the deficit that includes investment as spending—but not the net operating deficit. In turn, government’s

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\(^9\) Overall deficit refers to the statistical concept of deficit that treats the acquisition of fixed assets as spending. In the GFSM 2001 methodology it is called “net lending/borrowing,” in contrast with the “net operating balance,” which excludes acquisitions of fixed assets. IPSAS follows business accounting, which focuses on measures of the deficit that exclude investment spending, similar to the “net operating balance” in GFSM 2001 statistics.

\(^10\) In such cases other IPSAS standards, as IPSAS 13, may apply.
Table 1. Accounting for PPP Contracts in Government Accounts

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<tr>
<td></td>
<td></td>
<td>Net operating deficit 2/</td>
<td>Overall deficit 3/</td>
</tr>
<tr>
<td><strong>A. Construction of the PPP asset (both government and user-funded PPPs)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Recognition of asset/liability</td>
<td>*Increase in non-financial assets (service concession asset); *Increase in liabilities by full value of the asset</td>
<td>None</td>
<td>Increases by the full value of the asset/liability</td>
</tr>
<tr>
<td><strong>B.1. Contract operation (government-funded PPPs)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Payment to operator for services provided</td>
<td>*Expense, purchase of goods and services *Decrease in cash</td>
<td>Increases by expense, purchases of goods and services</td>
<td>Increases by expense, purchases of goods and services</td>
</tr>
<tr>
<td>3. Payment to operator for financial charges 5/</td>
<td>*Expense, interest *Decrease in cash</td>
<td>Increases by expense, interest</td>
<td>Increases by expense, interest</td>
</tr>
<tr>
<td>4. Repayment of principal (amortization)</td>
<td>*Decrease in liability *Decrease in cash</td>
<td>None</td>
<td>none, it is a financial transaction (below the line)</td>
</tr>
<tr>
<td>5. Depreciation of the asset</td>
<td>*Expense, consumption of fixed capital *Decrease in non-financial assets</td>
<td>Increases by expense, consumption of fixed capital</td>
<td>none, internal transaction 6/</td>
</tr>
<tr>
<td><strong>B.2. Contract operation (user-funded PPPs)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6. Revenue recognition and reduction of liability (imputed)</td>
<td>*Decrease in liability *Revenue, capital grant (imputed)</td>
<td>Decreases by revenues, capital grant</td>
<td>Decreases by revenues, capital grant</td>
</tr>
<tr>
<td>7. Depreciation of the asset</td>
<td>*Expense, consumption of fixed capital *Decrease in non-financial assets</td>
<td>Increases by expense, consumption of fixed capital</td>
<td>none, internal transaction 6/</td>
</tr>
<tr>
<td><strong>C. End of Contract (both government and user-funded PPPs)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8. End of service provision by the operator</td>
<td>Not a specific transaction</td>
<td>None</td>
<td>None</td>
</tr>
</tbody>
</table>

1/ Accounting on an accrual basis.
2/ The net operating deficit excludes net spending on nonfinancial assets (acquisitions minus disposals). It is closer to the IPSAS definition of deficit than the statistical concept of overall deficit.
3/ The overall deficit corresponds to net lending/borrowing according to GFSM 2001 methodology.
4/ Net worth equal total assets (financial and nonfinancial) minus total liabilities (debt liabilities and others).
5/ Splitting asset and service component of service concession arrangements by fair value (estimation techniques).
6/ The increase in expenses—consumption of fixed capital—is compensated by the reduction in nonfinancial assets by the same amount, so net lending/borrowing is not affected.
23. **During the PPP contract operation phase, the government’s liability related to the PPP is gradually extinguished.** In the case of government-funded PPPs, the government pays an amount that compensates the operator for financial charges, the services provided, and the repayment of principal. The amounts corresponding to service costs and financial charges are accounted for as government expenses and thereby affect the overall deficit (transactions 2 and 3), while the repayment of principal is accounted for as a reduction in liabilities (transaction 4) with the counterpart being a decline in cash (i.e., it is a financial transaction not affecting the overall deficit). Likewise, in user-funded PPPs, during the contract operation phase the PPP-related liability reduces as revenues are recognized (transaction 6 is imputed, since the operator does not transfer to government the service fees collected from users). In this case, the value of the government PPP-related liability is equal to the portion of revenues the operator has not yet earned. In both cases, the government depreciates the asset during the duration of the contract (transactions 5 and 7). While the treatment of government-funded PPPs (B1 in Table 1) is very similar to the treatment of financial leases in international accounting and relatively uncontroversial, the treatment of user-funded PPPs (B2 in Table 1) is more controversial. For example, in France a recent government accounting standard on PPPs uses criteria similar to those of IPSAS 32 to decide whether the government should recognize an asset on its balance sheet, but requires recognition of a liability only in the case of government-funded PPPs.\(^{11}\)

24. **At the end of the PPP contract the costs incurred by the operator are completely reimbursed by government.** As a result, for both types of PPPs the PPP-related liability is totally repaid (i.e., gross debt is zero); while the nonfinancial asset remains in the government’s balance sheet at its residual value (transaction 8).

B. **International Statistical Standards for PPPs**

25. **International statistical standards also reduce the incentive to pursue PPPs just to minimize the impact of investment on the main fiscal aggregates.** The IMF’s *Updated GFSM 2001*\(^ {12}\) and the *2011 Guide on Public Sector Debt Statistics* set out criteria for classifying PPP assets and associated liabilities and provide a consistent framework for reporting PPP transactions in government finance statistics. According to the *GFSM 2001*, if the PPP asset is regarded as a government asset, the impact on the fiscal deficit and debt are similar to the case of a publicly financed investment project.

26. **Under GFSM 2001, PPP assets are accounted for in the government’s balance sheet if the government bears most of the project’s risks and rewards.** The factors that need to be considered in assessing who bears most of the project’s risks and rewards (i.e., who has the economic ownership of PPP-related assets) are closely related to the conditions prescribed by IPSAS 32—including those factors associated with acquiring the asset and those

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\(^{11}\) See French Conseil de Normalisation des Comptes Publics (2011).

\(^{12}\) The updated GFSM 2001 refers to the November 2012 draft.
associated with the use of the asset. Risks associated with acquiring the assets are: the degree to which the government controls the design, quality, size, and maintenance of the asset, and construction risk. Some of the risks associated with using the asset in production are: supply risk, demand risk, residual value and obsolescence risk, and availability risk.

27. **Both IPSAS 32 and GFSM 2001 should usually lead, in practice, to the same decision as to whether a PPP contract creates assets and liabilities for the government.** While IPSAS 32 and GFSM 2001 approaches for asset recognition in the case of PPPs are different in nature, their implementation should typically lead to the same decision and therefore to a similar impact on main fiscal aggregates.

28. **In contrast, the implementation of Eurostat’s criteria for accounting for PPPs has resulted in many assets and related liabilities being treated off government’s balance sheet.** Although Eurostat uses the risks-and-rewards approach to determine whether a PPP asset can be considered as a government asset, its implementation according to Eurostat’s criteria can result in a different decision from that derived from IPSAS and/or GFSM 2001. In practice, Eurostat requires that the PPP asset should be reported as belonging to the operator if the operator bears the construction risk and at least one of either availability or demand risk, and there are no other mechanisms in place (such as guarantees or grantor financing) to return these risks to the government. Experience shows that under Eurostat’s criteria many government-funded PPP assets and related liabilities are recorded off government’s balance sheet. For user-funded PPPs (concessions), Eurostat’s criteria state that assets and liabilities are off the government’s balance sheet unless the government finances most of the investment or provides a minimum-traffic or minimum-revenue guarantee to the operator.

C. **Country Practices in Accounting and Reporting PPP Transactions**

29. **Most countries deviate from international standards—IPSAS 32 and GFSM 2001—when accounting and reporting for PPP transactions, which increases the bias towards PPPs.** Reasons for such deviations vary on a country-by-country basis, as well as countries’ capacity to avoid the PPP bias.

30. **Overall, fiscal accounting and reporting for PPPs is very limited, and comparing national practices is complicated by the fact that data on PPPs can be generated and reported in different ways along a typical fiscal cycle.** Figure 3 describes a typical fiscal cycle, identifies the main types of fiscal data generated during the cycle, and highlights the role of the accounting system in integrating fiscal data. A fiscal cycle typically begins with a medium-term economic framework (element 1) that sets the premises on which the

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15 This follows closely the description in the 2009 Fact Sheet, Government Finance Statistics (GFS), Statistics Department, IMF.
government’s budget is prepared (element 2). As the budget is executed (element 3), transactions are recorded in a financial accounting system, which generates various reports (element 4), such as intra-year budget execution reports and preliminary annual financial results. Following the end of the fiscal year, the final annual financial statements (element 5) are compiled and presented in an audited format (element 6) to the legislature and other oversight bodies. These results inform the decisions of the next fiscal cycle (element 1). The budgetary and accounting records, as well as the various reports produced during the cycle are the main inputs to compile fiscal statistics. In turn, headline fiscal indicators—including fiscal targets—are determined, often at a national level, and the extent to which they are based on budgetary, accounting, and statistical records varies by country. Finally, a variety of other fiscal reports may be produced, drawing on the accounting system and other sources, including analyses of debt sustainability, long-term fiscal projections, and statements of fiscal risk.

31. The way PPP transactions are reflected in the overall fiscal cycle depends on several factors. In most countries, user-funded PPPs are excluded from the budget (i.e., the type of project matters). Since budgets are normally on cash basis, they may not show PPP operations at early stages of the PPP cycle, even for projects committing government resources (i.e., the accounting basis matters). Moreover, even countries with accounting systems on an accrual basis may not show PPP operations if the related asset is regarded as being owned by the private partner or if it is owned by a public entity outside the coverage of national headline fiscal indicators (i.e., classification of the asset and institutional coverage of fiscal data matter). Finally, countries with no integrated financial accounting system may report PPP operations inconsistently among different fiscal reports. For example, PPPs can be excluded from budget execution reports but their related assets and liabilities can be classified as public following international accounting and statistical standards—IPSAS 32 and GFSM 2001—and thus be included in annual financial statements and fiscal statistics. Similarly, headline fiscal indicators and fiscal targets can be based on any of such reports, and they could even incorporate further modification—such in the case of the European Union. This hampers the decision making process (i.e., consistency in reporting also matters). Ensuring that all PPP projects are properly and consistently accounted for at every stage of the fiscal cycle reduces the incentive to pursue PPPs for the wrong reasons.

At the international level, the IMF’s Government Finance Statistics Manual 2001 (GFSM 2001) and guide on Public Sector Debt Statistics of 2011 provide guidance on the preparation of fiscal statistics. At the regional level, the European System of Accounts (ESA) 1995 sets out standards that are critical in Europe because they are the basis for measuring compliance with the debt and deficit rules.
32. **Both government-funded and user-funded PPP projects should be reflected consistently in all stages of the fiscal cycle.** In the case of user-funded PPP projects, the government normally does not expect any related drain in fiscal resources and therefore may consider excluding these projects from the budget. But care should be exercised when excluding these projects from the subsequent stages of the fiscal cycle. It should be noted that even though the government may not expect to incur any costs, the fiscal risks can still be significant and the government may be required to pay if, for example, initial conditions do not materialize. This would still call for government monitoring and reporting of their operations in the other reports generated during the fiscal cycle (e.g., a statement of fiscal risks as one of the special purposes reports).

33. **In countries where the government’s budget is on a cash basis, additional reporting is needed to adequately assess the fiscal implications of PPPs.** Particularly at early stages of the PPP project cycle, where the construction of the asset and the recognition of the related liability take place, the discrepancy between cash and accrual accounting of PPPs can be substantial. Although fiscal data prepared on a cash-only basis can in principle include the spending and revenue of PPP grantors, governments that produce cash-only data tend not to follow “substance over form” rules of the kind found in accrual standards that might require them to treat investment by a PPP as government spending. Under a cash basis, the fiscal deficit and debt do not necessarily reflect government’s medium and long-term commitments normally arising from PPP contracts. Therefore, to avoid the bias towards PPPs fiscal analysis should be complemented by other reports where the medium and long-term implications of PPPs are clearly acknowledged.
34. **Classifying the PPP asset as private or as belonging to a public entity outside the coverage of the headline fiscal indicators makes it easier for the bias toward PPP to persist.** Even under *IPSAS 32* standards, some PPPs may not be treated as creating government assets and liabilities. Moreover, some countries with advanced accounting follow accounting standards that differ from *IPSAS 32*, in particular in their treatment of user-funded PPPs. When a PPP asset is classified as private, related contingent liabilities or other fiscal risks can be reported in special purpose reports—such as fiscal risk statements. However, their usefulness to counter the PPP bias depends on the extent they inform the decision making process in a typical fiscal cycle. Similarly, when PPPs are contracted by public entities outside the institutional coverage of headline fiscal indicators (e.g., state-owned enterprises in the European Union), the capacity to reduce the PPP bias is weaker. Governments may disregard fiscal costs and risks not affecting their headline indicators or their fiscal targets, even though correctly accounted in other fiscal reports.

35. **Consistency in reporting PPP operations between various fiscal reports can help the government in making informed decisions about their future fiscal costs and risks.** Countries that implemented an integrated financial accounting system can ensure that government operations, and in particular PPPs, are reported consistently across fiscal reports (i.e., budget execution reports, financial reports, annual financial statements, statistics, headline fiscal indicators).\(^{17}\) Yet, integrated systems are rare and, in practice, most countries show inconsistencies when reporting PPP operations. For example, some types of PPPs are not included in budget execution reports, which are typically on a cash basis, while annual financial statements prepared in accordance to *IPSAS 32* would typically account for most PPPs. Similarly, fiscal statistics and headline fiscal indicators would exclude or include PPP operations depending on the main data source used to compile them (i.e., budget execution or financial statements). Failure to report PPP operations in headline fiscal indicators or fiscal targets complicates government decisions to pursue a PPP for the right reasons.

D. **What Can Governments Do to Minimize the PPP Bias?**

36. **There are several strategies for strengthening accounting and reporting of PPPs to ensure that they are pursued only when they offer value-for-money and are affordable.** For governments with the capacity to apply accrual accounting and statistics, the best strategy is to adopt standards such as *IPSAS 32* and *GFSM 2001*. However, this may prove challenging for most countries, at least in the short-term, and there are several other things that can be done.

\(^{17}\) They can still be different, but they can be easily reconciled. A chart of accounts compliant with international accounting standards can be harmonized with statistical reporting requirements, and can be adapted to specific report needs.
37. **All governments can benefit from disclosing supplementary information**—regardless of the complexity of their budgetary, accounting, and statistical standards—to **raise awareness of the long-term fiscal impact of PPPs**. This information could include supplementary statistics that provide medium- and long-term forecasts of PPP spending and revenue, descriptions of the contracts and their fiscal costs and risks, and the contracts themselves. The challenges of producing such information will vary among countries, and will depend on the level of development and the quality of the government’s information systems.

38. **Governments can disclose supplementary fiscal indicators in which all PPP projects are classified as belonging to general government or the public sector.** By doing that, even if international accounting and statistical standards are far from being fully implemented, the government can benefit from similar results. For example, governments can disclose a broader measure of spending that includes all PPPs, regardless of whether the PPPs are classified as public or private according to national standards. It is useful to present measures for the entire public sector. Under both accrual and cash accounting, even if the PPP project is classified as belonging to the public sector, it may not be classified as belonging to the government as defined in national standards underlying headline fiscal indicators. For example, this is the case when the institutional coverage of headline fiscal indicators is narrow (e.g., budgetary central government instead of general government or the nonfinancial public sector) and PPP-related asset and liabilities (as well as expenses and revenues) belong to a public body outside this coverage (e.g., a state-owned enterprise). The related assets and liabilities and revenues and expenses will be recorded in the state-owned enterprise’s accounts, but not those of budgetary central government, central government, or general government.

39. **Governments can also publish forecasts of the cash flows associated with PPPs.** These forecasts can facilitate a clear understanding of fiscal implications of PPPs beyond immediate cash drains. Whatever the basis of their accounts and statistics, governments can usefully produce long-term cash-flow forecasts that include availability payments, shadow tolls, and other relatively predictable cash flows between the government and the PPP contractor, as for example in Portugal and the United Kingdom. Where feasible, the expected values of less predictable flows can also be disclosed, as in Chile for payments associated with minimum-revenue guarantees.

40. **All governments can also include the expected fiscal cost of PPPs in their medium-term fiscal frameworks, debt-sustainability analyses, and other fiscal documents.** This will provide a consistent treatment of PPP operation in main fiscal reports. The medium-term fiscal framework should include planned spending and revenue related to

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19 See Chilean Budget Department (2011).
PPPs in the years covered by the framework—and, where possible, contingent liabilities as well. Debt-sustainability analyses should also incorporate these amounts. Finally, if the government publishes long-term fiscal projections, PPP spending and revenue should be part of the projections.

41. **Similarly, disclosing information on the risks associated with PPP contracts can give the government and the public a better sense of their long-term implications.** A report on fiscal risks associated with PPPs can supplement budget documents. That report can discuss how PPPs could cause spending to be higher, or revenues lower, than originally forecasted. Ideally, the discussion should be part of reports on all major fiscal risks, so that those created by PPPs can be seen in context. Examples of reports on risk can be found in Chile, the Philippines, and Portugal, among other countries.\(^{20}\)

42. **To further enhance transparency, governments can disclose PPP contracts on their websites.** The disclosures should include any amendment to original contracts, together with a summary of their main financial provisions. Certain material can be deleted on grounds of commercial confidentiality, but if the disclosure is to be useful the main financial provisions of the contract, including those in appendices and schedules, must be disclosed. Examples of disclosure can be found in Australia and Chile.

### III. Budgeting

43. **The design of the budgeting process for investment projects is crucial in ensuring that PPPs are used to support high quality public spending and do not put fiscal sustainability at risk.** The budget is where spending decisions are ultimately made. Thus, no matter how good the quality and availability of information on PPPs may be, the design of the investment budgeting process determines whether the approved public investment program properly reflects spending priorities and is consistent with sustainable public finances.

44. **With respect to PPPs, the budgeting process should take account of the following principles:**\(^{21}\)

- Decisions on investment spending should ensure that projects are chosen in line with policy priorities and that investment decisions are guided by cost-benefit analysis.

- The choice between PPPs and traditional public financing should be based on value for money, and thus the prioritization of investment projects should be independent of the method used to implement the project, except to the extent that the method affects value for money.

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\(^{21}\) See Hemming et al. (2006).
Spending decisions should be consistent with fiscal sustainability and thus take account of the long-term implications of spending programs on government finances.

45. **Budget choices between projects should be influenced primarily by policy priorities and by long-term budget affordability, and not by the timing of cash flows.**

If the budgeting process can be designed to ensure that the overall net project cost (cost of constructing and operating an asset or of making availability payments, net of potential user fees) and not the timing of the cash flows drives the investment decision, it is reasonable to factor in the choice of the financing method (PPP or traditional public financing) before prioritizing projects and before deciding on whether to include the project in the budget (Option A in Figure 4).

Otherwise, the decision whether to use a PPP should be taken only after the decision is made to include the project in the budget (Option B in Figure 4). In this case, the budgeting decision should be made on an investment project inventory in which all projects are presented as if they will be publicly financed. This ensures that all investment projects are assessed according to the same criteria—cost-benefit assessment, policy priorities, and affordability—irrespective of the ultimate financing method. Although it does not allow the assessment to take account of the possible benefit of using a PPP, it is the safer option if the PPP bias has not been removed by other means. Therefore, for countries with less developed budgeting process Option B could imply lower risks for government.

In addition to treating projects under different procurement methods equally, independent of the procurement method, the budgeting process needs to ensure that the full lifetime costs of an investment project are taken into account at the time of project approval. While this is true for any investment project, whether it is implemented as a PPP or with public financing, this is a particular concern for projects that involve large and complex asset investments with long construction and contract periods, which is often the case in PPPs.

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**Figure 4. Timing of Decision to Use a PPP in Budgeting Process**

- **Option A:** Decide whether projects should be undertaken as PPP
  - Selection of projects that have positive net benefits according to cost-benefit analysis
  - Prioritization of projects according to net benefits
  - Selection of projects that are affordable in the long term
  - Projects that are included in budget

- **Option B:** Selection of projects that have positive net benefits according to cost-benefit analysis
  - Prioritization of projects according to net benefits
  - Selection of projects that are affordable in the long term
  - Projects that are included in budget
46. **Governments can do different things to ensure that long-term budget affordability and not the timing of the cash flows drives the investment decision.** At the budgeting level, these are (i) a medium-term budget framework that treats PPPs as publicly financed projects, (ii) commitment budgeting, or (iii) a two-stage budgeting process.

47. **A medium-term budget framework that treats PPPs in the same way as it treats publicly financed projects is helpful if most of the cost of the investment project is recorded under the medium-term horizon.** As discussed in Section II, modern accounting and fiscal statistics increasingly treat PPPs as creating government assets. Thus, if the budget law requires authorization of the acquisition of government assets, it will require the authorization of investment in assets created by PPPs during the construction period. This approach is most likely to be adopted if the government’s budget is influenced by accrual-accounting principles, as in New Zealand where it has recently been used for the government’s first major government-funded PPP. But it could also be adopted under pure cash budgeting by treating PPPs as public projects, spending on which requires budget approval (i.e., if the PPP was recorded “on budget”). If the construction of an asset stretches beyond the time horizon covered by the budget and medium-term budget framework, however, this budgeting method does not ensure that the full financial implications of investment projects are considered when taking the investment decision.

48. **The use of commitment appropriations—in addition to spending appropriations—can address the affordability issue and help reduce the bias in favor of PPPs.** Under this budgetary process, which is used in France and Germany, the budget provides two kinds of authorizations, spending appropriations and commitment appropriations. Spending appropriations authorize government spending in the current year. Commitment appropriations authorize the government to commit public resources for future years. The information included in the budget could look as shown in Table 2. If authorization is required before the government enters into any long-term contract, the parliament will be informed about, and have the power to limit, the future implications of investment decisions, no matter whether they are undertaken as PPPs or as publicly financed projects. The presence of commitment appropriations also draws attention to the full future costs of all long-term investment projects, including PPPs. However, because commitment appropriations are not usually reflected in headline fiscal indicators, including the fiscal deficit and public debt, commitment budgeting does not necessarily eliminate the bias in favor of PPPs over public financing.

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23 See German government (2007) and German government (2011).
Table 2. Information included in the budget for commitment appropriations

<table>
<thead>
<tr>
<th>Commitment appropriations</th>
<th>Total</th>
<th>Current budget year (t)</th>
<th>t+1</th>
<th>t+2</th>
<th>t+3</th>
<th>Later years</th>
<th>Last year affected</th>
</tr>
</thead>
<tbody>
<tr>
<td>Project 1</td>
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<td>Project 2</td>
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49. Governments that do not have commitment appropriations could instead introduce a two-step budgeting process for PPPs and long-term investment projects. Under such a two-step process, all investment projects would have to be approved as publicly financed investments as part of the long-term government investment program. The presentation of the investment program would include all relevant information on the long-term implications on public finances, including operation costs. So that this step can ensure that the investment program is compatible with long-term fiscal sustainability, a decision on the procurement method would be taken only after a project has been pre-approved under the investment program. Only those projects that are pre-approved as part of the investment program could be included in the budget. This two-step approach could apply to all investments that extend beyond the horizon of the medium-term forecast and that exceed a certain maximum amount.

IV. Fiscal Rules

50. To encourage good budgeting decisions, the fiscal rules that guide budgeting may need to be modified to ensure that the fiscal implications of PPPs are taken into account. Fiscal rules usually set limits on some headline fiscal indicators, for example on public debt or on the fiscal deficit. The rules can be based on indicators that are derived from budgets, accounts, or statistics. As discussed above, depending on the standards followed, these may or may not create a bias in favor of PPPs. However, in most countries, the accounting underlying fiscal rules treats PPPs as not creating any government liabilities or spending in the short term. To the extent that the fiscal rules bind, they therefore create a bias in favor of PPPs. Removing this bias requires a change in the accounting underlying the rule, along the lines discussed in Section II. In particular, if the accounting treats the assets created in PPP projects as belonging to the government, and if a liability of equal value is recognized on the government’s balance sheet when the assets are created, then investment in a PPP will lead to the recognition of public expenditure and new debt in the same way as publicly financed investment. However, even with accounting standards that treat PPPs in the same way as publicly finance investment, affordability issues are not necessarily taken into account. Therefore, fiscal rules that refer to the lifetime spending or the full value of a project may be valuable.
51. **Specific ceilings on PPPs can be applied if the main fiscal rules fail to capture their fiscal consequences.** These ceilings should in general be guided by the following principles:

- Ceilings should cover both the stock and the annual flow of PPPs. A ceiling on annual PPP-related payments helps ensure that PPPs remain affordable. A ceiling on the size of the PPP program helps limit the government’s exposure to fiscal risks and prevent circumvention of the flow ceiling by pushing payments further into the future at a higher fiscal cost.

- The size of the PPP program should be measured using an unambiguous measure that captures fiscal costs and risks as far as possible. It is important for the measure to be unambiguous so that it is credible and can be verified by independent experts. Thus, simple methods that measure the PPP program for example based on the capital investment under the contracts or the present value of known future obligations of the government (e.g., availability payments) are most useful. If reliable valuation methods are available, the ceilings can be broadened to include the expected costs of contingent liabilities.

52. **There is no simple rule of thumb for setting the ceilings.** The assessment of the maximum size of a PPP program should be guided by the medium-term budget framework and debt-sustainability analysis that incorporates known government payments under PPP contracts and scenarios of what may happen with contingent claims from PPPs. The PPP ceiling should be consistent with affordability in the short, medium, and long term. See Box 2 for some examples of PPP-specific ceilings.

### Box 2. Examples of Ceilings for PPPs

**Brazil.** A ceiling on current spending from PPP contracts of 3 percent of net current revenue applies to all levels of government (articles 22 and 28 of the PPP law). That is, new PPP contracts cannot be signed if: (i) existing commitments already amount to 3 percent of net current revenue or (ii) the new contract would entail commitments in excess of 3 percent of net revenues at any time during the forthcoming 10 years. The Ministry of Finance is responsible, through an inter-ministerial council, for monitoring compliance with the ceiling, as well as for monitoring fiscal risks from PPPs (article 14).

**El Salvador.** The present value of the cumulative amount of quantifiable firm and contingent future payments, net of revenue, assumed under PPPs cannot exceed 5 percent of GDP.

**Hungary.** In a given budget year, the nominal value of new long-term commitments cannot exceed 3 percent of total state budget revenues. The ceiling does not apply to commitments of local governments or other general government units not covered by the state budget (e.g., the National Motorway Construction Company (NA)). Long-term commitments cover expenditures for investment, renovation, operation and maintenance, service purchase, and rents, including those arising from PPP contracts. See Hungary’s Concession Law 1991.

**Peru.** According to the Peruvian PPP law, the present value of contingent and noncontingent liabilities in PPP projects cannot exceed 7 percent of the GDP.
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