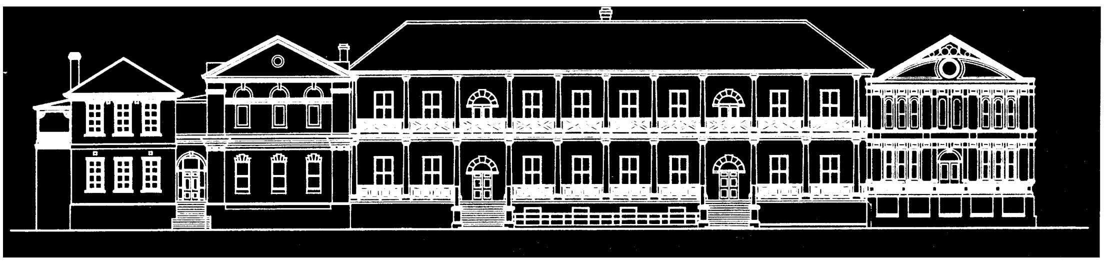
PUBLIC ACCOUNTS COMMITTEE

ED 100: ARRANGEMENTS FOR THE PROVISION OF PUBLIC INFRASTRUCTURE BY OTHER ENTITIES: DISCLOSURE REQUIREMENTS

Discussion Paper



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MEMBERS OF THE PUBLIC ACCOUNTS COMMITTEE

Members of the Public Accounts Committee of the 52nd Parliament:

Mr. Joseph Tripodi, B.Ec. (Hons), MP, Chairman.

Joe Tripodi was elected to Parliament in March 1995 as the Labor Member for Fairfield. Before entering Parliament he worked as an economist with the Reserve Bank of Australia and as a union official with the Labor Council of NSW. He has been a Member of the Committee since May 1995 and was elected Vice-Chairman in September 1996.

The Hon. Pam Allan, B.A. (Hons), Dip. Ed. (Syd.) Honours in Government, MP, Vice-Chairman

Ms. Allan was elected to Parliament on 19 March 1988 as the Labor Member for Wentworthville. Prior to entering Parliament, Ms. Allan served as an Alderman on the Parramatta City Council and as a delegate and later became Chairman of the Western Sydney Regional Organisation of Councils. During her Parliamentary career Ms. Allan has served as the Minister for Environment and Shadow Minister for Planning, Environment and Women's Affairs. Ms. Allan has served as member of the Joint Select Committee on Waste Management and was elected to the Public Accounts Committee on 3 June 1999 and appointed Vice-Chairman on 23 June 1999.

Mr. Ian Glachan, MP

The Liberal Member for Albury since 1988, Ian Glachan has had a varied background. He served five years at sea as a marine engineer, was a farmer for ten years, and operated a newsagency in Albury for 18 years. Mr Glachan is also a past president of the Albury-Hume Rotary Club and a Paul Harris Fellow, an active member of the Anglican Church, and was the Legislative Assembly member on the Board of Governors of Charles Sturt University. He is a former Chairman of the Public Accounts Committee.

Ms. Katrina Hodgkinson, MP.

Ms. Hodgkinson was elected as National Party Member for Burrinjuck on 27 March 1999. Before entering Parliament Ms. Hodgkinson was Executive Officer to the Federal Cabinet Minister, Senator The Hon. Nick Minchin. Ms. Hodgkinson is a partner in a wool and fine arts retail enterprise. She is a former property developer and is a former member of several rural economic based committees. Ms Hodgkinson was appointed a member of the Public Accounts Committee on 3 June 1999.

Mr. Richard Torbay, MP.

Mr. Torbay was elected an Independent Member for Northern Tablelands on 27 March 1999. Before entering Parliament, Mr.Torbay served the local community of Armidale. He is currently the Mayor of Armidale and has served in this capacity since 1995. He was previously Deputy Mayor and served on the Armidale City Council since 1991. Mr.Torbay has acted as Chairman of the NSW Country Mayor's Association, and is the Patron of Armidale District Chamber of Commerce. Mr. Torbay became a member of the Public Accounts Committee on 3 June 1999.

Mr. Barry Collier, B. Comm., Dip. Ed., Dip. Law, MP.

Mr. Collier was elected Labor Member for Miranda on March 1999. Before entering Parliament Mr. Collier was a Barrister practising criminal law (1997-98) and previously a solicitor from 1989 to 1996. Prior to being admitted as a solicitor, Mr. Collier was a high school teacher for 17 years, teaching economics, commerce and legal studies. He is a former President of the Legal Education Teachers' Association, a former Director of the Economics Teacher's Association, and is a published author having written *Introducing Economics 1, 2 & 3* - texts for HSC economics examination students. He chaired the NSW Economic Examination Committee for 3 years from 1985-1988. Mr. Collier was appointed a member of the Committee on 3 June 1999.

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TABLE OF CONTENTS

Chairman's Foreword

Over the years, the Public Accounts Committee has galvanised a substantial and widespread interest in issues arising from the provision of public infrastructure. The Committee's work has been acknowledged by the Australian Accounting Research Foundation in this currently proposed accounting standard for infrastructure projects.

Since 1993, the PAC has been at the forefront of scrutiny and comment on an area of public sector accounting that has needed to be more accountable and transparent. The lack of adequate accounting standards for infrastructure projects has increasingly become more urgent as the private sector increases its participation in these projects to some $70 billion dollars of investment nationally. This substantial investment in ports, airports, rail freight, gas and water, toll roads and hospitals has been facilitated by privatisations alone. Another $15 billion dollars of private investment has occurred in new projects.

There has been a general acceptance within the accounting and auditing profession that there has been a lack of clear accounting guidance in relation to such infrastructure transactions. This deficit has become apparent, not only, in NSW, but other states as well. Many of the financial reports relating to infrastructure transactions have attracted recurring audit qualifications from respective Auditor's-General across Australia. The accounting treatment of these projects has, for this reason, become an issue of pressing importance.

In preparing its submission to the Australian Accounting Research Foundation in relation to this proposed accounting standard, ED100, the PAC entered into a consultation process. This process served as a means of gathering diverse viewpoints and allowing the Committee to better gauge the adequacy of the proposed standard. During March 2000 the Committee convened a Round Table involving representatives from Treasury, the NSW Audit Office and Mr Rahoul Ray of PriceWaterhouseCoopers, to discuss past and present concerns raised by those agencies, to understand their expectations in relation to enhanced disclosure provided by the standard, to identify specific limits of reporting entailed by the standard, to ascertain any concerns within the standard relating to definitional quality, to determine emerging issues not adequately canvassed in the proposed standard and to discuss the incremental approach and future recognition of assets, liabilities, revenues and expenses relating to public/private infrastructure projects.

The Committee also commissioned expert assistance from Mr Rahoul Ray of Price WaterhouseCoopers. As a former Director of Structured Finance and Treasury in the NSW Audit Office, Mr Ray was able to bring to the Committee's submission, years of first hand highly specialised experience and knowledge of the issues concerned with the accounting and disclosing of information relating to these projects. Mr Ray worked closely with the Committee in preparing a detailed and highly professional analysis of the issues for which the Committee is extremely grateful.

Following extensive deliberation by the Committee in relation to Mr Ray's analysis, and in the interests of maintaining the integrity of Mr Ray's contribution, the Committee decided to submit this analysis in its entirety as its submission to AARF. The Committee believes that this submission addressees all the matters raised by it over the years in infrastructure and related reports 67, 73, 74, 76,77, 80 and 102.

Whilst the Committee is of the view that the accountability of infrastructure projects requires the introduction of additional new accounting standards, it is pleased that progress is being made in addressing disclosure requirements as a first step. The Committee looks forward to further enhancements through the introduction of additional accounting standards in the future.

Joe Tripodi

Joe Tripodi
Chairman

Acknowledgements

The Public Accounts Committee wishes to sincerely thank Mr Rahoul Ray of PriceWaterhouseCoopers for providing professional advice and substantial input in assisting the Committee in the preparation of its submission to the Australian Accounting Research Foundation.

The Committee also wishes to thank the Australian Accounting Research Foundation for allowing it to reprint the proposed accounting standard in this Discussion Paper

1. General Background to the Introduction of the Proposed Accounting Standard

1.1 Over recent years pressures have been brought to bear on governments to modernise and expand infrastructure facilities whilst simultaneously reducing levels of debt incurred by the increasing cost of providing infrastructure. At the same time, the competitive economic environment in which governments deliver infrastructure has made the provision of infrastructure goods and services more contestable.

1.2 The pressures on government in this contestable market has allowed the private sector to enter the infrastructure market in unprecedented fashion. As a result, many of the traditional lines of demarcation between public and private sector involvement have now become blurred. For this reason, various authorities and critics have focussed their interest on the financial reporting of infrastructure agreements. The Australian Accounting Research Foundation concedes that existing accounting standards do not include requirements that can now deal adequately with all the different types of transactions and events that may be encompassed under the different BOO and BOOT arrangements entered into between the public and private sector.

1.3 The need for greater disclosure and accountability has also become increasingly important as different levels of risk and return are now negotiated between public and private parties.

1.4 Whatever the risk/reward ratios may be agreed, governments still have an obligation to be accountable and transparent in the reporting of infrastructure transactions. Not only are the financial statements of government agencies still subject to traditional scrutiny by the Auditor-General, but government departments must also continue to satisfy the scrutiny of Parliament.

1.5 The issue of the disclosure of infrastructure projects as well as accounting treatment of those projects, has been a recurring subject of debate about an area of government functioning that has long required standardisation of reporting practice. By February 2000 the Australian Society of CPA's stated that:-

There are significant inconsistencies in accounting treatments among governments, particularly the level and quality of disclosures are not consistent.[1]

1.6 The Society added that:

…some critical areas of concern are the lack of disclosure of … related party transactions[②]

1.7 The purpose in enhancing disclosure, according to the Society, lies in the fact that financial accounts constitute an important source of information for decision making purposes. Such things as appropriate allocation of risk to parties best able to bear it, relies essentially on the provision of adequate financial information. The fundamental purpose of the financial accounts of government agencies, therefore, is to promote the competitive delivery of public infrastructure in an increasingly competitive and increasingly privatised market.

1.8 The Australian Society of CPA's has voiced its concerns about the reporting of infrastructure projects. It has advocated enhanced disclosure in terms of the type of information, format and amounts of monies disclosed, all within the context of recommendations for a more user friendly reporting framework.

1.9 The Australian Accounting Research Foundation has also expressed some concern in relation to recurring qualified opinions on the financial statements of government departments involved in the provision of infrastructure. The Foundation is of the view that this is largely a result of on-going competing opinions about how infrastructure transactions should be accounted for in those statements.

1.10 A number of other authorities and commentators have expressed concern about potential for variability in financial reporting practices. The Public Accounts Committee has frequently expressed concerns in the past that the controversy surrounding appropriate accounting treatments in the financial statements of government agencies has undermined confidence in public sector financial reporting. As the Society points out, government reports should be examples of best practice and accordingly should not need to be qualified.[①]

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① Australian Society of CPA's An Examination of Whole of Government Financial Reporting February 2000, page 6

② Ibid. page 6.

Audit Office Qualifications

1.10 In its report to Parliament of 1996, the NSW Audit Office recognised that the public sector in NSW had entered into a number of long term arrangements for the provision of public infrastructure and public facilities with the private sector.In auditing arrangements that constitute infrastructure transactions, the Auditor General formed an opinion as to whether the financial position and results and cashflows of the agencies involved in infrastructure provision were fairly presented. In other words, the audits sought to ascertain the extent to which the economic reality of the transaction was reflected in the financial statements. Audit opinions were delivered on many occassions within the context of disagreement between the agency and the Audit Office over the accounting treatment of these transactions, a situation aggravated by the lack of accounting standards.

1.10 Three audit qualifications were issued by the Auditor General that year on the basis of disagreement in relation to the accounting for such things as availability and usage charges entailed in infrastructure contracts. The audit opinion of Port Macquarie Base Hospital (June 30, 1995) related to contractual arrangements between the Department of Health and Port Macquarie Base Hospital. A stream of payments made by the Department to the provider of the hospital building were deemed be constitute availability which gave the Department the right to use the hospital building for the period of agreement. The Audit Office formed the view that of the existing accounting standards, the economic substance of this arrangement was most appropriately captured by the Australian Accounting Standard AAS 17 “Accounting for Leases”. On this basis, the Audit Office prescribed that obligations arising under this agreement be recognised as a liability in the financial statements of both the Department and the provider. The Audit Office argued that treating the accounts in this way would have materially affected the statement of assets by $50.9m and the liabilities by $53.1m leaving the net assets of the transaction reduced by$2.2m and the net cost of services raised to $2.2m.[①]

1.11 At the nub of the audit qualifications was the question of whether the State was faced with an asset and/or liability, from such transactions. The Auditor-General's 1996 Volume One report took the view that :

> *"In the absence of any specific existing accounting standard or prescriptive guidance, appropriate for such transactions, the Audit Office has relied upon an economic framework existing across a number of accounting standards*

and statements."

In this regard, a significant standard appears to have been Australian Accounting Standard AAS17 "Accounting for Leases", which provided a framework for distinguishing transactions into those that are 'agreements equally and proportionally unperformed' (AEPU) and those that deliver present obligations. AAS17 classified relevant AEPU transactions as operating leases (ie. off-balance sheet) and the latter as finance leases (ie. on-balance sheet). The Volume One 1996 Report stated that

> *"...the issue is not whether a transaction is a lease, but rather, in the absence of a "better" Standard, whether the economic framework in AAS17 could be helpful in assessing whether the transaction has attributes which may require recognition as assets and/or liabilities. AAS17 also assists in offering a perspective on which party (in substance) is the owner of the infrastructure".*

1.14 The audit qualification of the Water Board was compounded by a similar lack of clear accounting standards. In 1994, the Water Board entered into an agreement with the Sydney Water Corporation Limited for the provision of a sewage transfer scheme and two water filtration plants. The substance of the Audit Office’s concern lay in the payment of an availability change which was related to the capital costs and capital servicing costs of the asset and their ability to meet warranted capacity. The Audit Office again agreed that these

contractual arrangements amounted to a sufficiently substantial amount to warrant recognition in the balance sheet of the Board.

1.15 A qualification to the contractual arrangements entered into by the Sydney Water Corporation Limited were based on a similar lack of definitive accounting standards. Differences of opinion over the accounting of arrangements arose from one stream of payments relating to an availability charge which was connected with the service arrangements entailed by the transaction and qualified by the corporation’s ability to meet capacity and water quality criteria. In the same way as the Department of Health and the Water Board, Sydney Water Corporation Limited, did not recognise these payments in its statements. The Audit Office qualified its accounts on this basis.

1.16 In 1994, Public Accounts Committee Report 80 commented on the differing opinions expressed over recent years about how a public /private infrastructure transaction should be accounted. Concerns were subsequently expressed by the Auditor General in his report on the Roads and Traffic Authority in October 1994, in which it was stated that existing accounting standards did not adequately address infrastructure transactions.[1]

1.17 An EPAC Interim Report of May 1995 echoed the concerns of various agencies in relation to the financial reporting of infrastructure projects:

> *There is a widespread perception that accounting standards have not kept pace with the move to private financing of public infrastructure. According to the recent report by the NSW Public Accounts Committee several problems flow from the absence of definitive accounting standards in this area, including, the need for auditors to qualify financial statements that do not comply with current accounting practices. The existence of qualified accounts may jeopardise access to funds, and cause confusion that can jeopardise the credit rating of parties involved in an infrastructure proposal.*
>
> *The New South Wales government (has) argued that the development of appropriate accounting standards is an important part of the process of ensuring accountability and transparency in the reporting of the government's obligation and risk exposure.*[2]

1.18 The final report of the EPAC Taskforce (September 1995) also noted the increasing role of the private sector in these projects. It stated that whilst 90% of Australia's infrastructure valued at that time at approximately $400 billion was owned by the public sector, new gross investment at approximately $25 m per annum was increasingly involving the private sector. This and all other concerns expressed was making appropriate financial reporting frameworks an increasingly urgent issue.

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1 Australian Accounting Research Foundation Preliminary Viewers Paper 1997 page 4.

2 Cited in Public Sector Accounting Standards Board Preliminary Views Paper of the Australian Accounting Research Foundation, entitled, Private Sector provision of Public Infrastructure :Accounting for Public Sector Entities for BOO and BOOT Arrangements. 1997

2. Background to the Committee's Interest in this Proposed Accounting Standard

Introduction

2.1 The Public Accounts Committee has, over the years, taken an active interest in issues arising from the provision of infrastructure in NSW. The NSW PAC has led other states in Australia in reporting on the management, accounting and disclosure of infrastructure projects. This proposed accounting standard governing disclosure is, therefore, of particular interest to the Committee.

2.2 The Committee's current interest lies in the adequacy of the proposed accounting standard in relation to recommendations for enhanced disclosure made by it over the years.

2.3 The Committee regards the proposed introduction of additional disclosure requirements as the result of an historical process of debate and discussion about the need for enhanced disclosure, generated not only by the PAC since 1992, but also by the NSW Audit Office. The Auditor General's 1996 report to Parliament expressed concern about the disclosure of important liabilities in the State's accounts. Commenting on the accounting treatment for the private provision of public infrastructure in water and health projects, the Auditor General stated:

> *For many years the State has been a party to the complex financial arrangements which involve the supply of infrastructure and services. They have been the subject of numerous special reports in recent times as their number and complexity grew.*

PAC reports to Parliament

2.4 In July 1993, the PAC tabled the first of a subsequent series of reports on the management of infrastructure projects entitled *Infrastructure Management and Financing in New South Wales, Volume 1: From Concept to Contract – Management of Infrastructure Projects (*Report 73). This report was in response to significant political interest generated in the planning, financing and co-ordination of projects such as the Sydney Harbour Tunnel, the Monorail, Port Macquarie Hospital and select tollways. Whilst issues of the financing, the sharing of risk between the public and private sectors and borrowing was the focus of this report, the issue of accountability was also addressed in the report.

2.5 In addressing accountability, the report focussed on enhanced disclosure of

infrastructure projects. It advocated greater transparency and accountability through the dissemination of information contained in infrastructure contracts. This information was deemed to be necessary over and above information accessible under the Freedom of Information Act. The Committee made a detailed recommendation that contract summaries disclose the following information:

- the full identity of successful proponents, including details of cross ownership of relevant companies;
- the duration of the contract;
- the identification of any assets transferred to the contractor;
- all maintenance provisions;
- the price payable by the public ;
- the basis for changes in the price payable by the public;
- provisions for negotiation;
- the results of cost benefit analyses;
- risk sharing in the construction and operation phases;
- significant guarantees or undertakings, including loans entered into or to be entered into by the public sector, with an estimate either the range or maximum amount of any contingent liability; and
- any protection in the contract against excessive profits and any remaining key elements of the contractual arrangements.

2.6 The Committee specified that it was not necessary for the private sector's internal cost structure and profit margins to be disclosed, matters having an intellectual property characteristic or any other matters where disclosure would substantially commercially disadvantage the contracting firms with its competition.

2.7 In making these recommendations, the Committee believed that their specific nature and the narrower ambit of the exemptions identified meant that there would be wider disclosure than that which occurred under the Freedom of Information Act.

2.7 In PAC report 76, entitled *The Financing of Infrastructure Projects, Discussion Paper,* (November 1993) the Committee again stressed the need for transparency in the provision of infrastructure in NSW. In this report, the Committee argued that there should be greater disclosure of the arrangements entered into in various BOO, BOOT and BOT infrastructure contracts than that facilitated under the Freedom of Information Act.

2.8 The Committee recommended that details of infrastructure contracts

should be made available to the Parliament and the public for the purpose of better understanding the government's position in the provision of infrastructure. The Committee insisted that:

> *If government wishes to enter into a public-private partnership, its reasons for doing so must also be made transparent. If the government sees social or economic benefits in the project whose returns, especially in the early years, may not be commercially acceptable, these benefits must be made clear to the Parliament and the public.*[3]

2.10 Disclosure within the framework of contract summaries was also regarded as a convenient alternative to the lodgement of an application for information under the Act. It was seen as an efficient means of readily accessing vital information for interested parties.

1.17 In 1994 the PAC tabled another report on infrastructure and, once again, commented on the adequacy of the reporting framework within which infrastructure projects were undertaken. Report 80, entitled *Infrastructure Management and Financing in NSW : Volume 2 : Public-Private Partnerships – Risk & Return in Infrastructure Financing* advocated greater involvement by the private sector in infrastructure provision whilst also calling for greater accountability:

> *… the public infrastructure needs of the community will only be met if there is a substantial private sector involvement,*
>
> but;
>
> *… there is great public suspicion about private sector involvement in infrastructure deals with government.*[4]

1.18 The spread of risk and return and the public's confidence in the appropriate apportioning of risk was also of concern to the Committee:

> *… this is especially so where government and private companies share the financial risks on projects such as toll roads, water treatment works and prisons.*[5]

[3]PAC Report 76 The Financing of Infrastructure Projects:Discussion Paper November 1993 page 11

4 Australian Accounting Research foundation Op Cit. page 3
5 PAC Report 80 Chairman's Foreword page 5

2.12 The issue of the reporting of risk within an operational framework of risk sharing with the private sector was a foremost consideration in PAC report 80.

The report acknowledged that, until 1994, the public sector had financed virtually all infrastructure under its own accounting requirements and that, as no mixed public /private entities had existed, the reporting entity was clearly the public sector body. The Committee conceded that, up to that point in time, the question of who was the reporting entity in the provision of infrastructure had been largely irrelevant. The infastructure market was clearly evolving.

Conclusion

The Committee has long recognised that the complexity of arrangements has meant that reforms in reporting practices of government agencies has needed to be introduced in stages. It commends the Public Sector Accounting Standards Board for responding to the PAC's and other agencies calls for additional standards. The Committee recognises that, whilst its concerns over time have related to more than just disclosure, this proposed standard will undoubtedly facilitate further developments in accounting treatments in the future.

THE PUBLIC ACCOUNTS COMMITTEE'S RESPONSE

to the

ED 100 : *Arangements For The Provision Of Public Infrastructure By Other Entities: Disclosure Requirements*

With thanks to Mr Rahoul Ray

of PriceWaterhouseCoopers-