

# Let's have less bias and better analysis

Without it, PFIs do not have credibility - but they're the only show in town. David Heald reports

THE Private Finance Initiative is now an important means of public procurement for hospitals, prisons and schools. But discussion of it usually resembles a dialogue of the deaf, with positions struck according to people's views about the proper role of the state in providing public services.

This obscures the fact that there are good and bad arguments for the PFI. So what are the good arguments?

First, the design and construction phase of a project may be better run. Other members of a PFI consortium discipline a construction firm more effectively than can the public-sector client, purging the contractual claims culture - bid low, then bargain for extras - which contributes to overruns of time and cost. If PFI leads to tight initial specifications, the public-sector client cannot make big design changes during construction.

Second, as financial markets become more sophisticated, expertise in risk management grows, bringing specialisation in evaluating and bearing risks.

Third, private financing makes it easier to make charges to users 'stick' - an advantage if charging is appropriate.

Fourth, the combination of private financing and third-party charging might provide some protection against 'pork barrel' politics, whereby white elephant projects are funded in politically sensitive constituencies.

There are two arguments in favour of PFI that are bad, logically flawed and advanced purely as policy alibis.

First, private finance enables projects to be undertaken which the public sector could not afford. But where there are no third-party payers, the exchequer will eventually have to meet the full service cost. Unless there are genuine efficiency gains from private-sector involvement, this simply means the retiming of when the taxpayer incurs the cost. The temptation to post bills to the future can become irresistible.

Second, it is frequently hinted that

PFI represents a mechanism for manipulating the public spending and borrowing figures. But despite the element of arbitrariness at the margin of public expenditure scoring rules, they have an important function in recording what is happening to resources in the economy and should not be manipulated.

The gulf between what is said publicly and what is acknowledged privately has widened alarmingly. Those involved in the PFI have learnt the storyline, making the point that the public sector is now contracting for services, rather than assets. Where valid, this is an important distinction.

However, everyone knows that PFI is often the only show in town - there will be no project if PFI is not shown to be best value for money. The Government's rhetoric about public service reform emphasises devolving power to organisations and managers, but that is not the reality. In fact, unprecedented top-down control has created perverse incentives.

Accounting always involves judgment. Accountants have come under pressure, or been seduced, to exercise that judgment in support of predetermined positions, such as keeping debts off balance sheets through special purpose vehicles - companies set up by members of PFI consortiums to handle particular projects - whether these are for Enron or for NHS hospitals.

There was conflict in 1998 between the

## The Treasury's dual role as the promoter and regulator of PFI has created serious problems

Accounting Standards Board and the Treasury over FRS5A, the accounting standard issued to cover PFI. The Treasury also produced guidance for use by the public sector, and commissioned from PricewaterhouseCoopers a methodology on how to determine whether a particular asset is off-balance sheet to the public-sector client.

Auditors are put in the difficult position of being asked to approve the prospective off-balance sheet treatment proposed by the public-sector client's financial advisers, without which approval there will usually be no investment. An issue that arises is the repackaging of construction risk, not relevant to accounting treatment under FRS5A, as design risk. Another issue is the underestimation of demand risk, which arises if serviced school or prison places

under a 30-year PFI project turn out to be in excess of requirements. These issues can make the auditors complicit in the keeping assets off-balance sheet and compromise their future independence of judgment.

Regarding value for money, much appraisal of this is contracted out to consulting firms. At its worst, this becomes policy advocacy on a deniable basis. Whatever the technical competence of the work, its commissioning provokes a cynical response, as with the reports on the Public Private Partnership for London Underground.

The corrosiveness of such an environment is worrying, and senior finance officials in public-sector clients must alternate between pleasure at ending years of capital starvation and a sense of vulnerability that professional and political support will evaporate if projects encounter problems.

Credibility is stretched when PFI projects are repeatedly assessed as marginally superior to the public-sector comparator (that is, what would be done if there were Exchequer funding), after the addition of a sum representing the value of risks transferred to the private sector.

After 10 years of the PFI, it must be possible to do better. First, it has to be recognised as an important new procurement method, but one that must be tested against other methods without privileged treatment.

Second, the laxity of PFI accounting has to be challenged. The Treasury's dual role as PFI promoter and regulator has created serious problems, not least its tolerance of inadequately performed accounting and value-for-money tests.

Third, value-for-money testing prior to a decision has to be rescued from the present cynicism, when the result of PFI superiority is tacitly understood as imperative. For example, the loss of policy flexibility under 30-year concessions, and the capability of special purpose vehicles and their parent companies to withstand adverse outcomes, needs to be systematically assessed.

Fourth, retrospective assessment of value for money has to be more rigorous, not least to establish which of the good arguments for PFI have borne fruit. In particular, good construction performance would be persuasive, and the lessons might well improve conventional procurement.

The quality of analysis must be improved urgently, or the way in which the NHS has pre-empted other programmes in this year's government spending review makes it likely that other departments and agencies will conclude that there is no alternative to PFI.

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