

# *Risk, VFM and Partnerships*

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# *My thesis*

*Understanding risk is central to getting VFM from public/private partnerships*

*Yet, it has been widely misunderstood and misapplied*



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# *History of thinking about risk in PPPs*

*No risk transfer = Poor VFM*

*True*

*Implies less risk falling on public sector than conventional finance*



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# *History of thinking about risk in PPPs*

*Therefore: the more risk transfer the better*

*False: some risks are expensive for the  
private sector to bear*

*Actually said by HM Treasury*



# *History of thinking about risk in PPPs*

*No, better to transfer appropriate risk*

*Fine as far as it goes*

*What is 'appropriate'?*

*How to handle novel risks?*

*Can what is appropriate change over time?*

*Is 'transfer' the right word?*



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# *Hang on a minute!*

*High risk transfer = off-balance sheet treatment.*

*Why we might want that*

- *Loophole in spending controls*
- *Lower public debt figures*

*Who might want it*

- *The Authority*
- *The Treasury... sometimes*

*Who decides*

*And by what principles*



# *VFM and Accounting Treatment*

## *OFF balance sheet*

- *High risk to private sector*

## *Therefore:*

- *Potentially high gain*  
*at*
- *High cost*

## *ON balance sheet*

- *Low risk to private sector*

## *Therefore:*

- *Probably low gain*  
*at*
- *low cost*

**But VFM = Gain/Cost**

**That ratio is independent of the accounting treatment**



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# *False but long-lived*

*HM Treasury ca. 1992-96*

*DoH guidelines to NHS on PFI (current)*

*DfES approach to schools PFI in  
England (current)*



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# *Off-Off Cases*

*Off public sector balance sheet*

*Off private sector balance sheet*

*So, who owns the asset?*

*Technically feasible, but...*



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# *Motives for (self-)delusion*

*PPP/PFI only show in town*

*“Buy now, pay later” always attractive*

*Therefore strong incentive :*

*to achieve off balance sheet treatment – even to extent  
of loading extra risk into project!*

*to manipulate investment appraisal to “justify” VFM  
of PPP option*

*And strong possibility:*

*Of limiting risk analysis to achieving short term aim  
only*



# *Risk and public sector comparators*

*PSC: “risk-adjusted costing of conventional project delivering same benefits as proposed PPP”*

- *Risk adjustment crucial...*
- *... but*
  - *How much?*
  - *Who decides?*
  - *How sure can they be?*
- *What a PSC can show*
- *What it can't*



# *Is risk transfer the right concept?*

*Fundamental difference between partnership working and traditional*

- *Different risks*
- *Borne by different people*
- *Subject to different incentives*

*Size of residual public sector risk*

*Black and white view mistaken*



# *Dangers of the black and white view of risk allocation*

*It's false!*

- *All PPP risks, always, shared:*

*Key issue is “how”*

*It's dangerous!*

- *Plays to adversarial view of contract management*



# *Risk and capital structure*

*What equity capital is for*

*How much is needed*

*Equity capital in practice*



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# *Misunderstood and misapplied*

*Risk allocation*

*Accounting treatment*

*Public sector comparators*

*Risk transfer*

*Risk and capital structure*

*What are the barriers to getting these things right?*



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*Any Questions?*



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