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# The valuation of risk transfer in UK school public private partnership contracts

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ABSTRACT

A number of studies have examined the public private partnership (PPP) policy and have questioned the risk transfer argument used by the UK government to legitimise its adoption. This paper contributes to the literature by illustrating how accounting numbers have been used to value risks and justify the PPP decision. Data from the full business cases of two UK PPP schools and semi-structured interviews are used to illustrate the complexities and subjective judgements involved in valuing risks and achieving optimal risk transfer. The analysis suggests that the accounting numbers used to value risks are not neutral or objective but are socially constructed and may be manipulated to justify the PPP decision.

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## 1. Introduction

Public private partnership (PPP) or private finance initiative (PFI) is now an established model used by governments across the globe to procure infrastructure-based public services (De Vries & Yehoue, 2013; Grimsey & Lewis, 2005; Hodge, Greve, & Boardman, 2010). As of March 2012, the UK government has signed £54.7 billion worth of PPP contracts whilst £5.4 billion worth of PPPs were still in the procurement process (HM Treasury, 2012). The UK government used the value for money rhetoric to legitimise the use of PPP by arguing that it enables better sharing of risks and rewards between the public and private sector partners than would be possible under conventional public sector procurement (HM Treasury, 2003a, 2003b).

A number of studies have examined specific aspects of the PPP policy including appraisal and value for money tests (e.g. Heald, 2003; Khadaroo, 2008; Shaoul, 2005), risk allocation and diffusion ( Broadbent, Gill, & Laughlin, 2008; Demirag, Khadaroo, Stevenson, & Stapleton, 2012; Froud, 2003), post-implementation evaluation (Broadbent, Gill, & Laughlin, 2003), financing issues (Asenova & Beck, 2010; Demirag, Khadaroo, Stevenson, & Stapleton, 2011) and the return on investment to PPP investors in the National Health Service (Hellowell & Vecchi, 2012). Whilst Broadbent et al. (2008) and Shaoul (2005) have examined the PPP decision-making and legitimation processes in the hospital sector and have pointed out that risk transfer is important as the value attached to risks has the ability to shift the balance in favour of either conventional or PPP procurement, they did not examine the valuation of risk transfer. Similarly, Demirag et al. (2012) focussed on examining how risks are diffused by PPP financiers and argued that the risk diffusion process and the consequent need for advice add cost to PPP projects impacting on the government's economic argument for risk transfer.

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This study contributes to the PPP literature by: developing a theoretical model of the relationship between risk transfer and value for money to highlight the importance of risk transfer and, illustrating how risks are actually valued in UK school PPP contracts. It uses data collected from the full business cases of two PPP schools and fifteen semi-structured interviews conducted mostly with financial advisors. The findings shed light on the complex and subjective technical model used by financial advisors to value risks which presents opportunities for window dressing the PPP decision.

This paper is structured as follow. The next section develops a skeletal framework for understanding the valuation of PPP risks. It discusses the role of accounting numbers in government accountability processes and the legitimation of the PPP decision and, examines the theoretical relationship between risk transfer and value for money. The third section explains the research methods used to collect and analyse data. The fourth section presents the findings by discussing how PPP risks were identified and allocated, and how accounting numbers were deployed to value risks and justify the PPP decision in the case of the two PPP schools. The final section concludes the paper.

## 2. Accounting for PPP risks

### 2.1. The role of accounting numbers in government accountability processes

Governments' preoccupation with accounting numbers can be traced back to "the New Kingdom (1552–1069BC) in ancient Egypt" (Ezzamel 1997, p. 563). Ezzamel (1997) found that economic activities were coordinated by a powerful bureaucratic government in which accounting played a major role by providing visibility through quantifying input-output relationships, construction of inventory lists in palaces, temples, breweries and royal granaries, and documenting income for taxation purposes. Accounting was also instrumental in constituting exchange reciprocity between parties by developing metrics of quality and quantity, and in legitimising the authority and power of state officials.

Similarly, in contemporary society, Rose (1991, p. 673) argues that the exercise of politics in a democracy depends on the "technology of rule, and quantification, numeracy and statistics". Modern governments attempt to use numerical technologies for the political problematisation of issues such as national income, inflation, interest, benefits, population, immigration and crime. They rely on experts and depend on a population of actors who are literate and engage in numericised civic discourse of programmes of government. Rose (1991) states that political decisions affecting our lives entail the deployment of numbers in their calculation and legitimation. Our images of political life are shaped by what numbers disclose regarding the activities or realities of our society. However, Rose (1991) noted that acts of social quantification are politicised, not because the numbers governments use are somehow corrupt, although they may well be, but because of the political judgements involved in what to measure, how to measure, and how to present and interpret results.

Gorz (1989), in his work entitled the *Critique of Economic Reason*, argues that accounting calculation, rules and procedures are narrow and result in the reduction of thinking to technique, allowing economic calculation to become a substitute for value judgement. Gorz (1989, p. 122) suggests that accounting, formalised into calculation procedures and formulae, is "inaccessible either to debate or reflection" resulting in the colonisation of administrative systems and lifeworld by specialised professional bodies and experts. Gorz (1989, p. 479) states that economic rationality or reason formalised into (ac)counting technique has resulted in "debates between experts, quibbling over technicalities of method and not with the substance of the debate, or at least only concerned with the substance in so far as it is the unspoken hidden agenda of a technical debate on method". Money, which translates values into hard numbers, is significant in the process of economic reasoning and enables principals to exercise some sort of "action at a distance" (Robson, 1992, p. 685).

Gorz's (1989) critique of accounting may be partly attributable to his narrow conception of accounting which is often formalised as rules, techniques, and economic rationality (or counting). In this respect, Power (1992, p. 497) argues that Gorz's and other theorists' rejection of economic reason and calculation demonstrate ignorance of the possibilities of accounting and "non-calculative practices within which particular regimes of accounting might function". Without rejecting calculative rationality, Power (1992) suggests that accounting is not sufficiently well understood for its social and environmental potential to be dismissed. Contrary to Gorz's (1989) conception of accounting as a privileged form of certainty, Power (1992, p. 486) argues that "accounting brings with it many uncertainties and indeterminacies of its own". Accounting offers the potential to account for non-financial issues (Kaplan & Norton, 1992; O'Dwyer, Owen, & Unerman, 2011), and therefore technical calculations which focus on counting and ignore the social settings and judgemental processes through which numbers are constructed are one-sided and portray an incomplete picture of a course of action or policy.

### 2.2. The role of accounting numbers in the legitimation of the PPP decision

Accounting numbers apparently enable the government to reduce ambiguities by quantifying complex concepts such as risks (Knights & Vurdubakis, 1993). The government's preoccupation with quantifying risks may be attributable to the claimed representational accuracy and legitimacy of numbers in scientific theory literature (Mattessich, 1962; Watts & Zimmerman, 1986). The narrow notion of risk, which has gained popularity in modern society, is often defined and quantified in terms of the financial consequences of an adverse event occurring (Beck, 1999; Keynes, 1937; Knight, 1921; Power, 2007).

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