



## WIDP Guidance on submitting a Variation Business Case

July 2017

### 1. Introduction

Defra recognises and fully supports the effective management of existing waste contracting arrangements, and that the need to review their strategic relevance and efficiency is essential to good governance. To assist authorities in fulfilling this requirement, this note has been prepared by the Waste Infrastructure Delivery Programme (“**WIDP**”) for authorities which have a Waste Infrastructure PFI contract (“**WI Contract**”). It provides guidance to such authorities, should they wish to:

- make a Change (as defined in the WI Contract);
- enter into any arrangements which are of equivalent effect to a Change;
- take any measures which are in contravention of any part of the Waste Infrastructure Credit Letter / PFI Credit Letter (“**WIC Letter**”) issued to such Authority in connection with the WI Contract; and/or
- otherwise make a departure from the Final Business Case (“**FBC**”) presented to WIDP prior to the award of any PFI Credits / Waste Infrastructure Credits (“**WIC**”).

If the Change or other measures referred to above are considered to be material (a “**Material Change**”) then Defra requires the Authority to submit a Variation Business Case (“**VBC**”).

Before considering any changes to the WI Contract or FBC, an Authority should review the WIC Letter which confirmed the award of WIC for the project, and any other applicable guidance issued by Defra/WIDP and HM Treasury from time to time.

Defra does not offer exhaustive guidance on what is considered “material”. Defra’s view as to what may constitute a Material Change is set out below. This is a non-exhaustive list and Defra reserves the right to add to and refine this list from time to time. The following matters may be considered a “Material” change:

- 1.1. a significant change to (i) the outputs required under the WI Contract, and/or (ii) the capital assets; and/or
- 1.2. a change that alters the risk allocation under the WI Contract; and/or

- 1.3. a change stated in the WIC Letter to require the approval of Defra/WIDP, or a change which has previously on other projects required the approval of HM Treasury, e.g. refinancing, a capital contribution, etc.; and/or
- 1.4. any change which, when assessed in accordance with the Eurostat Guidance “A Guide to the Statistical Treatment of PPPs”<sup>1</sup> may result in the WI Contract coming “on-balance sheet” for the Government (also see Section 5 below); and/or
- 1.5. any change or series of changes which may, on implementation, have a significant departure from the approved FBC (for example, but without limitation, a change which has an impact on recycling rates).

Authorities should carefully consider the materiality of any proposed change, and discuss the change with their WIDP Transactor well in advance of formally submitting a VBC. Authorities should take appropriate professional advice (where relevant).

The changes listed above are not limited to a WI Contract change. They might include entering into (or changing) a side letter or associated agreement in connection with the project, or issuing a waiver not envisaged in the WI Contract, or following a course of action in fact which is in contravention of the express terms of its WI Contract.

## 2. What type of changes should be notified to WIDP?

The list below provides some guidance on changes which will normally need to be notified to WIDP. In some cases the approval of Defra will be required before the change is made. The purpose of the list is to provide a degree of consistency when dealing with changes. The list is not exhaustive, and it will be updated to reflect experiences from other contract changes.

Changes which are crossed in the column marked “A” will possibly require the submission of a VBC, while changes which are crossed in the column marked “B” are highly likely to require the submission of a VBC. Please note, however, that these classifications are for example purposes only, and you are strongly advised to consider the specifics of your potential changes with your WIDP Transactor, as other factors may affect the treatment of your potential change.

	Change description	A	B
2.1	A change to/impacting the level of recycling and/or the diversion level / threshold / target including those stated in the payment mechanism.	x	

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<sup>1</sup> [http://www.eib.org/epec/resources/publications/epec\\_eurostat\\_guide\\_ppp](http://www.eib.org/epec/resources/publications/epec_eurostat_guide_ppp)

2.2	The Contractor ceases to have a contractual obligation to use (in whole or in part) the facilities under the WI Contract to contribute to recycling or landfill diversion (including mothballing/closing part of the assets) such that, if taken together with previous similar actions, the capital value of the facilities concerned exceeds the lower of £5m or 5% of the project's capital value <sup>2</sup> at financial close.	x	
2.3	Where the change results in an adjustment of 10% or more of the Unitary Charge, or saving in any year (compared to the Unitary Charge forecast before the change in real terms).	x	
2.4	If the capital value of any single change exceeds the lower of £5m or 5% of the project's original capital value <sup>3</sup> (at financial close).	x	
2.5	A change in the treatment of the assets at the expiry of the WI Contract to non-reversion (i.e. the Contractor retains the assets).		x
2.6	A change in the WI Contract period / extension (which was not envisaged in the WI Contract).		x
2.7	A change that has the effect of increasing the public sector WI Contract liabilities (including compensation on termination).		x
2.8	A WI Contract change that departs from the standard form contract terms (SoPC) or other HM Treasury / WIDP guidance.		x
2.9	A change to the risk allocation in the WI Contract.		x
2.10	A proposal to terminate the WI Contract.		x
2.11	Refinancing.		x
2.12	A capital contribution or offering of any other assistance (e.g. taxes/rates/duties waived, or provision of any guarantees or other financial support to, or for the benefit of, the Contractor or any related party in connection with the PFI Contract).		x
2.13	Any other change, when considered in the light of previous changes, has the cumulative impact of a change in the Government's on/off balance sheet assessment of the project.		x

In assessing any particular change, it is *strongly advised* that early engagement between the Authority and the relevant WIDP Transactor will assist in development and classification of that

<sup>2</sup> For the purpose of calculating capital value, Authorities must solely consider the cost of the capital assets constructed and not any additional or ancillary costs (including, by way of example, debt costs attaching to financing such assets).

<sup>3</sup> See footnote 2.

change. It will also ensure WIDP has the necessary resources to address your particular change. When notifying WIDP regarding a potential Material Change, Authorities should submit a 1-2 page commercial summary to enable WIDP to assess the most appropriate format for the VBC submission. Your WIDP Transactor may be able to assist in highlighting any particular areas this summary should cover. It is important that this summary is as clear as possible to enable Defra to make an informed decision on the proposed change. To the extent the change develops after submission of this summary, you may be required to update and re-submit the summary.

### **3. Non-material changes**

If the commercial summary referred to in section 2 concludes that non-material changes are proposed to the WI Contract, the WIDP Transactor will discuss the proposed change with the WIDP Commercial Team, and queries might be directed to the Authority. At any point during these discussions WIDP is entitled to require the Authority to submit a VBC and commence the VBC process. In the absence of this, and once the WIDP Commercial Team is satisfied, the WIDP Programme Manager will issue a letter confirming that Defra is satisfied that the proposed change (on the basis of information provided to, and assessed by, Defra) is a non-material change.

Examples of non-material changes may include 1) changing the fleet of refuse collection vehicles; 2) changing the opening hours of the household waste recycling centres; and 3) changing the logos/signs on the facilities.

### **4. Information to be contained in a VBC**

The format of the VBC will be decided by WIDP and communicated via the WIDP Transactor, but it is likely that the VBC should contain at least the information listed below. It is the responsibility of the Authority to include all relevant information in the submission to WIDP. There is no need to re-submit information previously provided in the FBC, but in some cases it may be appropriate to include a mark-up of the FBC.

4.1 Current project status (by reference to changes from the FBC), which should include, where relevant but without limitation:

- a. waste arising (and forecast going forward);
- b. any changes to the FBC, including without limitation the collection and disposal arrangements;
- c. Facilities delivered and third party facilities used (e.g. landfill) under the WI Contract and non-WI Contract (if any); and
- d. Recycling and diversion outcome (actual and expected/forecast going forward).

4.2 How the WI Contract has performed to date (including the performance framework, general satisfaction, deductions, key issues, and excess income).

4.3 Proposed changes and implications/impacts:

- a. description of key changes; and

- b. impact on risk allocation and contractual structures (please include the change documentation/drafting), including details of:
  - i. changes to the Payment Mechanism;
  - ii. changes to the WI Contract;
  - iii. legal opinion on procurement issues (if any);
  - iv. updated ESA 2010 questionnaire; and
  - v. other risks.

#### 4.4 Cost, Budget and Finance update (an update to section 8 of the FBC), e.g.

- a. Project cost / revenue analysis, including a revised financial model with sensitivity analysis as appropriate;
- b. affordability analysis;
- c. details of the savings expected, including whether they will be achieved in phases, and the value at each stage;
- d. analysis of the implications of the changes on the balance sheet classification of the project after considering the Eurostat Guidance<sup>4</sup>;
- e. conclusions regarding VfM.

#### 4.5 Council approval

- a. due diligence (advisers/team involved); and
- b. approval process/timetable.

4.6 Record of any other changes: a comprehensive record of all previous changes to the WI Contract and/or the FBC, including those that have been notified to WIDP and agreed as not being material to the decision to award WI Credits. This is to avoid the possibility of WIDP not being informed of “creeping change”, whereby a number of small changes which might not be material by themselves when added together result in a material change, e.g. if an Authority makes ten separate capital contributions to fund ten unrelated additions to the facilities, this is treated as a single issue rather than ten distinct changes. For further detail on this, see Annex 2.

Authorities might find it useful to link the description and evaluation of the changes being made to the HM Treasury Green Book Guidance on Public Sector Business Cases using the Five Case Model<sup>5</sup>. By way of a brief reminder, the Five Case Model involves looking at the:

- Strategic Case;
- Economic Case;
- Financial Case;
- Commercial Case; and
- Management Case.

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<sup>4</sup> See footnote 1 above.

<sup>5</sup>[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/469317/green\\_book\\_guidance\\_public\\_sector\\_business\\_cases\\_2015\\_update.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/469317/green_book_guidance_public_sector_business_cases_2015_update.pdf)

## **5. Balance sheet classification for National Accounting purposes**

One important aspect in the assessment of any Material Change is the potential balance sheet classification of the project as a result of that change. We refer to the letter issued by Defra to the Chief Executives of Local Authority Waste PFI projects on 17 October 2016 (see Annex 1) and to ESA 2010 and the related Eurostat Guidance.

Part of the review of the FBC would have been an assessment by Defra of the accounting treatment of the project for Budgetary and National Accounts purposes. This would have been done by analysing an Authority's responses to the ESA 95 Questionnaire.

A review of the VBC will involve a further assessment by Defra of the accounting treatment of the project for Budgetary and National Accounts purposes. This will be assessed against the relevant guidance in place at the time of the VBC, which is currently ESA 2010.

Authorities should note that any proposed changes which would lead to a project being classified to the public sector and thereby transfer to the Government's balance sheet would certainly be viewed by Defra as a Material Change. For further detail on this, see Annex 2.

## **6. Timeframe for review**

WIDP can give no guarantee over the time it will take to review a VBC, as this depends on the nature of the change, the information provided, and possible involvement from HM Treasury. Ministerial sign-off will be required for some changes and this could add time to the process. However, we require that an Authority submits a VBC<sup>6</sup> at least 6 weeks before it hopes to receive formal approval for the changes.

## **7. Method of approval**

Once in receipt of the VBC, WIDP may ask the Authority for clarification on some of the points. A record of the discussions will be kept in a Clarifications Matrix, which will be shared with the Authority. When WIDP's queries have been satisfied, it shall make a recommendation to the WIDP Board, and in certain circumstances seek Ministerial/IPA/HMT approval. If the WIDP Board / Defra Ministers approve the VBC, a new WIC Letter will be issued confirming if any changes are required to the level of WIC, and the terms and conditions of the award of WIC.

## **8. VBC Disclosure Requirements**

WIDP's view is that the final VBC report should be made publicly available on the Authority's website (subject to the redaction of any commercially sensitive and confidential information).

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<sup>6</sup> Note that this indicative timeline is from submission of a final VBC. It is anticipated that the VBC will have been shared in draft in advance so that Defra can review/comment. The 6 week period is for Defra governance and obtaining all necessary approvals.

## Annex 1 – Defra balance sheet classification letter



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for Environment  
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Chief Executives,  
Local Authority Waste PFI projects

*By email only*

**Your ref:**  
**Our ref:**  
**Date:** 17 October 2016

Dear Chief Executives,

### **WASTE PFI CONTRACT VARIATIONS AND THE QUESTION OF RECLASSIFICATION FOR NATIONAL ACCOUNTING PURPOSES**

Since the launch of the Operational PPP Efficiency Programme, Defra has been working together with Local Authorities contracting under waste PFI contracts to explore potential savings. With Local Authorities coming under ever increasing budgetary pressures we recognise that you are reviewing your options under the PFI contract to help find savings where possible whilst still retaining service delivery as set out in your Final Business Case.

We understand that Authorities account for PFI assets in the same way as property, plant and equipment owned by them. The assets and liabilities are recognised on the Authorities' balance sheet. However, for Central Government, all PFI projects are considered to be off balance sheet for the National Accounts as computed by the Office for National Statistics. They therefore do not count towards the Government's primary fiscal aggregates: PSNB (Public Sector Net Borrowing) and PSND (Public Sector Net Debt).

Before a contract variation is signed, to the extent that Defra is informed, Authorities will usually be required to submit a Variation Business Case documenting the case for the variation. If a variation to the Contract were to have the effect of, for example, transferring risk to the public sector, Defra would be required to reassess the classification of the project in terms of National Accounts balance sheet treatment.

Where any proposed change to a waste PFI contract prompts a change of the grant payments to the project so as to bring it onto the Government's books, this will require a fundamental review of the project's accounting treatment. If a PFI project were now to be

classified to the public sector and thereby transfer to the Government's balance sheet, this would mean that Defra would have to make budgetary adjustments to reflect all remaining capital contributions for the project. These offsetting adjustments are likely to render the proposal unaffordable for Defra in the current climate. A local authority that decided to proceed with the change in these circumstances would be at risk of having their grant funding reduced or withdrawn.

From our discussions with some Local Authorities, some of the initiatives being considered have the potential to realise significant savings and are driven by the changes in the waste sector environment, for example technology, availability of third party processors, economies of scale etc. However, before any detailed discussions with contractors, or before financial advisors are fully engaged, it is important that the outline of your proposals are discussed with your Transactor so that we can determine what the implications of any such change to the contract may have, not only with regard to the terms and conditions set out in the WIC letter, but also in terms of any future accounting treatment for the project within the National Accounts and hence affordability.

Yours sincerely

Marian Holliday  
Programme Director  
Waste Infrastructure Delivery Programme (WIDP)

**Email:** [widp.programmeoffice@defra.gsi.gov.uk](mailto:widp.programmeoffice@defra.gsi.gov.uk)

cc: Local Authorities' Section 151 officers (Finance Directors, Chief Finance Officers)  
WIDP Transactors  
Niranjan Patel  
Duncan Powell  
Tony Hitching



## Annex 2 – Balance sheet treatment classification

The Eurostat guidance requires all the provisions of the relevant contract<sup>7</sup> that influence the statistical treatment to be identified, and listed according to their category of importance (i.e. ON BALANCE SHEET, VERY HIGH, HIGH or MODERATE).

The Eurostat guidance is not relevant to existing projects which were signed prior to the guidance coming into effect, however where any such project is changed the change must be assessed in the context of the guidance. For this reason, Authorities must think carefully about any potential changes. Under the Eurostat Guidance, for example, 3 changes (whether occurring concurrently or at different times, even if they have unrelated subject matter) which are classified as “HIGH” would result in a project coming on the Government’s balance sheet. This means that Authorities must carefully consider the need for any change not just on its own merits, but also in the context of changes which have occurred before or any future likely changes.

The guidance acknowledges that it would not be appropriate to use a purely quantitative or scoring approach to assess the statistical treatment of a project. However, it states that there would be a strong presumption in favour of the project being off balance sheet if it has the number of provisions stated below:

VERY HIGH	HIGH	MODERATE
No more than 1	0	No more than 2
0	No more than 2	No more than 1
0	No more than 1	No more than 4
0	0	No more than 7

If a project has a combination of VERY HIGH, HIGH and/or MODERATE provisions that does not fall within one of the thresholds listed above, there is a strong likelihood that Eurostat will conclude that the project is on balance sheet for government.

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<sup>7</sup> This includes any related documents and the underlying law.