Auditing P3 Projects: Challenges, Opportunities and Lessons Learned

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Presentation Overview

PART I – CONTEXT

- What are P3s? – A Canadian perspective
- P3s in the Canadian Economy
- Differences between P3 and conventional procurement contracts

Presentation Overview

PART II – CCAF-OIAD Research Project

- Special characteristics of P3s from an auditor's perspective
- Main challenges in auditing P3 projects
- Which project phase to audit?
- Audit issues and opportunities to add value
- Lessons learned in auditing P3s

What are P3s?
A Canadian Perspective

- Alternative way of delivering large infrastructure projects
- Long-term cooperative venture agreements
- Allocation of resources, risks and rewards between public and private sectors
- Involving performance-based payments
- Control and ownership maintained by public sector

P3 Projects are Multi-Phased

Decision → Planning, Procurement & Design → Construction → Operations & Maintenance → Project Closure

P3 contracts can take different forms:

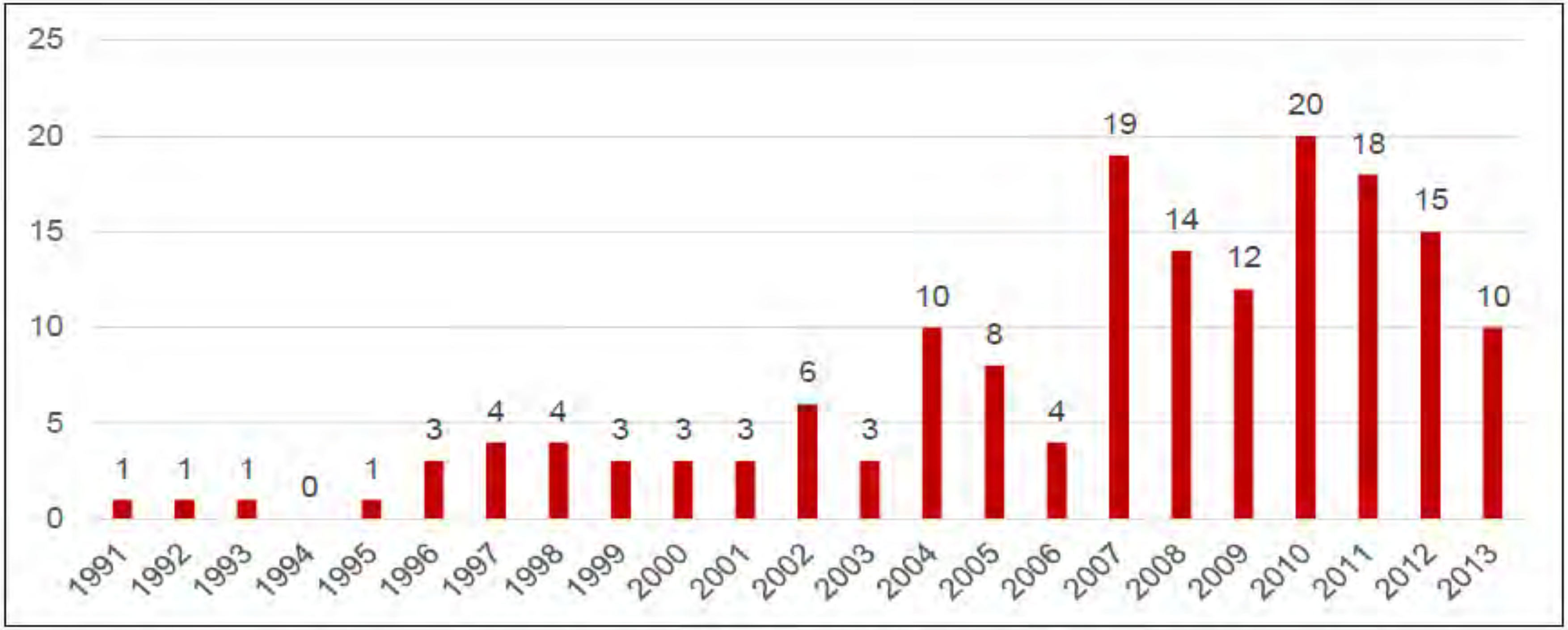
- Design-Build (DB)
- Design-Build-Finance-Maintain (DBFM)
- Design-Build-Finance-Maintain-Operate (DBFMO)
- Design-Build-Maintain-Operate (DBMO)

Summary of Infrastructure P3 Projects by Province and Sector, 2003-2013

Sector	Defence	Education	Environment	Govt Services	Hopitals & HC	Justice	Real Estate	Rec & Culture	Transportation	Total	Percentage
Province											
Alberta		3	3			1			5	12	10%
British Columbia			3		10	2	1	7		23	19%
Manitoba			1						2	3	2%
New Brunswick		1			1	1			2	5	4%
Ontario	1		1	2	39	10	1	6	5	65	54%
Quebec					9			1	3	13	11%
TOTAL	**1**	**4**	**8**	**2**	**59**	**14**	**2**	**14**	**17**	**121**	**100%**
Percentage	1%	3%	7%	2%	49%	12%	2%	12%	14%	100%	

Source: Prepared based on Table ES-3 of *10-Year Economic Impact Assessment of PPP in Canada*, CCPPP/InterVISTAS study (http://www.pppcouncil.ca/resources/issues/economic-impact-of-p3s.html) Updated to August 2013 using the CCPPP P3 Project Database (http://projects.pppcouncil.ca/ccppp/src/public/search-project?pageid=3d067bedfe2f4677470dd6ccf64d05ed)

Increasing Frequency of P3 Projects (1991-2013)



Source: The Canadian Council for Public-Private Partnerships (CCPPP) Project Database.
Note: Includes all P3 projects (infrastructure projects, services contracts, etc.) from 1991-2013. Additional data on two projects are included as of December 31, 2013, which became available following the data set used in the Economic Impact project sample.

Differences between P3s and Conventional Procurement (1)

	P3 Procurement	Conventional Procurement
Project Phases	• Integration of project phases into one contract (DB, DBFM, etc.) • Efficiencies and cost savings by combining all phases	• Separate contracts are negotiated by government for each project stage/phase

Differences between P3s and Conventional Procurement (2)

	P3 Procurement	Conventional Procurement
Contracts	• Outcome-based • Project outcomes are determined by public sector • Private sector consortium determines best way to meet requirements • Integrated, complex contracts • Fixed Price Contracts - Private sector assumes cost overruns • Milestones, deliverables & completion dates	• Output-based • Public sector determines exact outputs through detailed specifications • Separate contracts for different phases • Public sector absorbs project cost overruns • Decision and planning phases are shorter

Differences between P3s and Conventional Procurement (3)

	P3 Procurement	Conventional Procurement
Timing of Payments	• First payment at substantial completion or milestone • For financed projects, payments are spread over the contract term • Maintenance payments begin upon construction completion and are paid over the term of the contract	• Regular (e.g. monthly) payments are advanced to contractors based on percentage of work completed throughout construction term • Project holdback usually released upon successful completion of project • Commitment to incur ongoing operational and maintenance costs is discretionary

Differences between P3s and Conventional Procurement (4)

	P3 Procurement	Conventional Procurement
Financing	• Winning consortium responsible for obtaining own financing in private sector • Consortium finances upfront capital costs and recovers investment over term of the contract • Discipline provided by private sector financial institutions	• Limited private sector financing • Project usually financed by government sector through capital contribution or long-term debt • Government financing interest rates usually lower than what can be obtained by project consortium
Stewardship	• Overall control of project execution transferred to private sector • Public sector retains ownership	• Overall control of project execution remains with public sector

Differences between P3s and Conventional Procurement (5)

	P3 Procurement	Conventional Procurement

Risk Allocation	• Distribution of financial, technical and operational risk ideally between the private and public sector partners
	• Risks are assessed and optimally allocated, including:
	  • Design
	  • Construction
	  • Operations
	  • Financing
	  • Maintenance
		• Risks associated with project construction and post-construction operation fully allocated to public sector

Special characteristics of P3 projects (1)

- **Integration**: project phases combined into one contract
- **Duration**: often over a 20 to 40 year time frame
- **Risk sharing**: allocation of risks between public and private sectors
- **Payments**: milestones, deliverables, schedules, penalties, bonuses, monitoring requirements

Special characteristics of P3 projects (2)

- **Complexity**: may involve many stakeholders working on large, highly technical projects
- **Uncertainty**: unknowns and risks involved in making financial projections over 20-40 years
- **Up-front planning process**: VFM analysis is an extra step; greater emphasis on integrating design, build and operational requirements

Main Challenges in Auditing P3s (1)

- **Length and complexity of P3 projects**:
    - Large number of documents spanning many years
    - Steep learning curve for auditors
    - Often need specialized expertise – sometimes difficult to find independent experts
    - Audit planning phase takes longer and costs more than for audits of traditional procurement

Main Challenges in Auditing P3s (2)

- **Challenging tasks:**
  - Reviewing VFM assessments for assumptions used, risk allocations and risk valuations
  - Assessing the adequacy of key assumptions used for VFM long-term financial estimates
  - Difficult to answer all questions categorically – often, '…was reasonable at the time' is all that can be said

Main Challenges in Auditing P3s (3)

- **Access to information**:
  - Staff turnover across many years results in poor corporate memory and documentation gaps for both public and private sectors
  - Commercially sensitive information
  - Cabinet confidences
  - Complicated if negotiations are still ongoing

Main Challenges in Auditing P3s (4)

- **Dealing with multiple stakeholders**:
  - Multiple government entities and private sector partners – accountability and responsibilities may not always be clear, which may complicate access to information and result in conflicting opinions
  - Private partners may not want to collaborate
  - Pending lawsuits may prevent discussions from taking place

Which Project Phase to Audit? (1)

- All project phases can be audited – each has its own significant risks
- Due to P3 complexity and limited audit resources, it is often practical to focus on a single phase
- Auditors can plan to do more than one audit for long-term, complex projects with significant risks

Which Project Phase to Audit? (2)

- Audits done prior to contract signatures may influence project management and contribute to successful project outcomes.
- For project phases after the contract is signed, recommendations will mainly apply to future procurements – it will generally be too late to modify contracts. Lessons learned can be applied to new P3 projects.

Audit Issues and Opportunities to Add Value(1)

Decision Phase

The VFM assessment is a key audit issue

- Auditors can highlight areas of improvement in:
  - Guidance supporting the VFM assessment process
  - Assumptions and data used in financial models
  - Assessment methodology
  - Review and oversight processes
  - Supporting documentation for the VFM process

Audit Issues and Opportunities to Add Value(2)

Decision Phase

For risk assessments and risk valuations

- Auditors can assess:
  - Risk identification processes and valuations
  - The adequacy of data supporting risk allocation decisions and risk valuations (was it based on previous projects or educated guesses?)
  - The adequacy of assumptions made in the decision making processes

Audit Issues and Opportunities to Add Value(3)

Planning/Procurement/Design Phase

- Auditors can assess:
  - The clarity of roles and responsibilities of the P3 partners and of other relevant departments as they evolve during the term of the agreement
  - The completeness and clarity of contract clauses
  - The fairness and transparency of departmental procurement processes & P3 agencies
  - The measures taken to manage conflicts of interests
  - The financial viability of private sector partners

Audit Issues and Opportunities to Add Value(4)

Construction Phase

- Auditors can assess:
  - o Whether projects are on time, on budget (review at project or portfolio level)
  - o Project management and oversight processes in departments and/or P3 agencies (including monitoring and reporting)

Audit Issues and Opportunities to Add Value(5)

Operations & Maintenance Phase

- Auditors can assess:
  - Effectiveness of contract management processes
  - Contract monitoring capacity of public sector entities
  - Value-for-money of long-term P3 maintenance agreements vs. traditional maintenance arrangements

Audit Issues and Opportunities to Add Value(6)

Operations & Maintenance Phase

- Auditors can also assess:
  - o Measurement of results against initial project objectives (increased safety, better service quality, etc.)
  - o The achievement of expected project outcomes
  - o The adequacy of reporting on project performance over time

Opportunities to Add Value throughout the P3 process

Auditors can:

- Provide an unbiased objective voice to the P3 debate
- Endorse increased transparency of P3 projects
- Promote better governance over P3 projects
- Recommend enhanced project documentation and retention of information throughout the lifecycle of P3 projects
- Facilitate guidance, promote best practices, and share lessons learned

Lessons Learned in Auditing P3s (1)

- Difficult to audit P3s due to length of P3 agreements and complexity of large scale infrastructure projects
- Requires specialized expertise – may need external consultants as advisors or team members – or may outsource the audit
- P3 audits take more time and resources, but are feasible if sufficient time, expertise and resources are provided

Lessons Learned in Auditing P3s (2)

- Managing expectations: Difficult to conclude categorically on some questions because of uncertainties and long time frames involved
- VFM assessments may be biased and difficult to validate
- Cost is not the only factor in the VFM equation – innovation is another one

Conclusion

- P3 projects are a growing trend in Canada
- Relatively few P3 audits have been completed to date despite significant risks and materiality
- Auditing P3 projects is challenging but feasible with proper expertise and resources
- Auditors can play an important role in augmenting the Value-for-Money of P3 projects

Thank You!

Questions?

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