Adding Value: An audit reference manual on Public-Private Partnerships

Prepared for:

Internal Audit & Advisory Services
Office of the Comptroller General
Ministry of Finance

Prepared by:

Robert Bigalke
November, 2002
Table of Contents
Section ........................................ Page No.

Executive Summary ................................................................. 1
Summary of Recommendations .................................................. 7
1.0 Introduction ........................................................................... 8
  Purpose ....................................................................................... 9
  Objectives .................................................................................. 9
  Methodology/Approach ............................................................... 10
  Report Structure ........................................................................ 10
2.0 Understanding Public-Private Partnerships ............................. 11
  2.1 What are P3s ......................................................................... 11
  2.2 Types of P3s .......................................................................... 13
  2.3 Benefits of P3s ....................................................................... 19
  2.4 P3 Life Cycle .......................................................................... 25
  2.5 Common Risks ........................................................................ 31
  2.6 Best Practices Characteristics and Attributes ......................... 47
3.0 Jurisdictional Review of P3 Related Audit Activity ............... 54
  3.1 Canada & USA ....................................................................... 55
  3.2 United Kingdom (UK) ............................................................... 60
  3.3 Australia & New Zealand .......................................................... 64
  3.4 International Organization of Supreme Audit Institutes ............ 68
4.0 Role of Internal Audit & Advisory Services ............................ 69
  4.1 Other Suppliers of P3 Related Services ................................... 70
  4.2 Types of P3 Related Services ill Suited to IAAS ....................... 78
  4.3 Types of P3 Related Services Best Suited to IAAS .................... 79
  4.5 Level of Internal Audit Activity Based on Life Cycle Phase ....... 81
  4.5 Audit Services Based on Risk Assessment .............................. 86
5.0 Internal Audit P3 Practice Aids .............................................. 87
Bibliography ............................................................................... 90
Appendix 1 - Summary of UK partnership models .................... 93
Appendix 2 - Examples of P3 Case Studies .................................. 95
Appendix 3 – Discussion of the UK Public-Sector Comparator experience .......... 104
Appendix 4 – Procurement Attestation Audit Framework .............. 107
Appendix 5 - Value for money in a private sector financing partnership procurement - Applying the NAO framework .......... 110
Appendix 6 - IOSAI/NAO P3 Value for Money Audit Guidance ......... 114
Appendix 7 - Possible Audit Objectives and Criteria by Life Cycle Step .......... 122
<table>
<thead>
<tr>
<th>Figure</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Figure 1</td>
<td>Classification of P3s by level of partner interaction</td>
<td>14</td>
</tr>
<tr>
<td>Figure 2</td>
<td>Public-Private Partnerships and the Risk-Transfer Continuum</td>
<td>15</td>
</tr>
<tr>
<td>Figure 3</td>
<td>MSRM Partnership Types</td>
<td>17</td>
</tr>
<tr>
<td>Figure 4</td>
<td>The dimensions of P3s</td>
<td>19</td>
</tr>
<tr>
<td>Figure 5</td>
<td>Summary of Potential Benefits from P3s</td>
<td>24</td>
</tr>
<tr>
<td>Figure 6</td>
<td>Typical P3 life cycle model</td>
<td>26</td>
</tr>
<tr>
<td>Figure 7</td>
<td>Examples of risks associated with benefits of P3s</td>
<td>32</td>
</tr>
<tr>
<td>Figure 8</td>
<td>Examples of common P3 risks by life-cycle phase</td>
<td>45</td>
</tr>
<tr>
<td>Figure 9</td>
<td>A governing Framework for New Arrangements</td>
<td>58</td>
</tr>
<tr>
<td>Figure 10</td>
<td>Summary of OAG High Level Questions</td>
<td>59</td>
</tr>
<tr>
<td>Figure 11</td>
<td>NAO Partnership Relationship Framework</td>
<td>62</td>
</tr>
<tr>
<td>Figure 12</td>
<td>Related IAAS Goals and Objectives</td>
<td>70</td>
</tr>
<tr>
<td>Figure 13</td>
<td>Level of Potential Value Added by Internal Audit Involvement</td>
<td>82</td>
</tr>
</tbody>
</table>
Executive Summary

Governments around the world are using Public-Private Partnerships (P3s) and the Provincial Government has indicated its support of developing such partnerships in BC. In anticipation of client demand for audit services and advice related to Public-Private Partnerships Internal Audit & Advisory Services (IAAS) is developing its capacity to deliver such services and advice. The purpose and main objectives of this project are to contribute to the development of the branch's internal capacity to deliver P3 related audit and advisory services and recommend the types of services the IAAS is best suited to provide.

Public-Private Partnerships have been in use for over two decades and there is a vast amount of literature related to P3s: what they are, guidelines, best practices, and benefits. Therefore, the methodology and approach for the project included researching and reviewing literature on P3 theory, policies, guidance and practices of: the BC government; other public sector jurisdictions; academic literature; and private sector organizations.

The report is organized to first, provide the reader with an understanding of P3s - What they are and are not; the types of P3s; their purported benefits; best management practices; and common risks associated with P3s by consolidating the significant aspects of the literature. Next, is a summary of P3 audit activity and issues gathered from other jurisdictions. The third section of the report summarizes P3 activities of other organizations in BC and suggests areas where the IAAS is best positioned to provide value-added services to clients. The final section and related appendices provide some preliminary guidance, frameworks, objectives and criteria for auditors to use in planning various P3 related audit and review projects.
There are a variety of partnership types, but in general a P3 is a form of alternate service delivery distinguished by a multi-year collaborative relationship between public and private sector partners and a sharing of resources, risks and rewards as a method of best meeting clearly defined public needs. Much of what makes for successful P3s such as leadership, having well defined goals and objectives, extensive consulting with stakeholders, information sharing, trust, and good accountability is not new. (Lindquist, pg. 23). However, for successful P3s a number of less traditional attributes such as risk tolerance, flexibility, common values and principles, compatibility, and a willingness to share power are also required.

Ministries may enter into partnerships for a variety of purposes and to achieve a number of objectives. Proponents cite a number of benefits for using P3s such as to improve service, reduce government costs, build on private sector expertise, promote innovation, leverage resources, and promote economic development. Understanding the purported benefits of P3s is important to auditors in assessing the rationale for, the risks associated with, and the performance of P3s. The benefits of P3s are not universally accepted and are openly disputed by groups such as public sector unions and some experts. Therefore, auditors should also be prepared question the veracity of the arguments supporting the projected benefits of P3s.

The other side of any potential benefit is risk. Understanding the significant risks associated with P3s is key to providing effective value added internal audits, reviews and advice. Most risks associated with P3s can be classified into two broad categories: protection of the public interest and value for money. Many of the risks associated with P3s are similar to those for any other public
sector program or project. However, because of the horizontal partnership nature of P3s and the involvement of the private sector in the delivery of public services some risks are more significant for P3s than for traditional public sector programs or projects. For example, a lack of: clear roles, responsibility and accountability; assignment of risks, common objectives, values and principles; competition and transparency; stewardship of public assets; performance reporting and access to information; and regular communications to name a few.

For the most part the other jurisdictions reviewed, with the exception of the UK have not done extensive audit work related to P3s to date. Generally P3 audit activity has concentrated on evaluating and assessing various significant attributes of well established P3s such as value for money, performance, and accountability.

As the internal auditor to the Provincial Government IAAS is in a unique position to provide a variety of value added P3 related services to ministries. The provision of such services also aligns well with IAAS's mission, goals and objectives. Therefore, to meet clients' needs and attain high levels of client satisfaction, the branch should be prepared to offer P3 related services to client ministries.

There are a number of public and private organizations in BC such as: Partnerships BC; the Office of the Auditor General of BC; ministry partnership departments; and private sector accounting, consulting and legal firms that currently offer P3 related services. Some of these organizations have assumed roles that would compete directly with the IAAS while others have more complementary roles.
Partnerships BC for example, plans to have its own internal audit department and discussing the respective roles of IAAS and Partnerships BC’s internal audit department will be important to establishing IAAS’s role with respect to providing P3 related services. It will also be important for IAAS to establish and maintain co-operative relationships to exchange information with ministry departments involved in partnership activities and communicate with the Auditor General to co-ordinate P3 audit activity to avoid duplication.

Some of these other organizations such as Partnerships BC, internal ministry departments, and private sector law, accounting and consulting firms are also already well positioned to provide specialized P3 consulting and advisory services. IAAS currently does not have comparable resources, expertise or experience that would enable it to compete with these other organizations in delivering similar services. In addition, providing specialized consulting and advisory services could impair IAAS’s independence and its ability to provide P3 related assurance services.

However, IAAS can continue to offer and provide the types of consulting and advisory services for which it already the capacity and expertise in such areas as governance, accountability, performance measures, accounting and auditing based on staff core competencies and knowledge of the public sector. These services would be of value to ministry management of both public sector programs and P3s.

In addition, IAAS should continue to develop its capacity to provide traditional internal audit services related to P3s. Based on existing skill sets within IAAS and the range of activities encompassed by P3s the best opportunity for the IAAS to provide value added services to ministry clients is by providing various more traditional
audit related services. Such services would include, but would not necessarily be limited to: Assurance Services; Risk and Controls Reviews; Performance and Operational Auditing; Due Diligence Reviews; Attestation Services; and Compliance and Financial Auditing.

Being internal to government provides IAAS with the opportunity to adopt a more proactive and forward looking approach to its services than its competitors. Designed to assist ministries in improving operations in order to achieve objectives, such an approach would increase the value of IAAS services as compared to those of external auditors. Therefore, when ever possible the IAAS should take a proactive forward-looking approach to its provision of P3 related audit services.

IAAS can provide internal audit services throughout the life cycle of a P3. However, by focusing its services on those areas providing the highest potential value to clients IAAS can increase the general effectiveness of its P3 audit activity. For example, proactive audit involvement early in the P3 life cycle through services such as, risk and controls, and accountability reviews have the potential for very high value. This is because ministries can more easily implement suggestions for improvements made by IAAS prior to signing contracts, or during implementation than after systems contracts, and processes have already been established. However, other audit services such as performance and operational audits done during the operations phase of the life cycle will also provide significant value and should not be ignored. Figure 13 on page 82 illustrates the potential level of value added resulting from various audit services for each life cycle phase and general risk area.
IAAS regularly undertakes its audit work in areas of greatest risk and potential benefit, whether the services are delivered directly by the public sector or through alternate service delivery. Therefore, it is important that IAAS work with ministries to ensure any P3s are included in the ministries' Enterprise-wide Risk Management plans so that the risks associated with P3s may be compared to other possible audit projects when planning annual audit activity.
Summary of Recommendations

Internal Audit & Advisory Services should:

- discuss with Partnerships BC the planned role for its internal audit department and how IAAS could provide assistance;

- establish and maintain co-operative relationships to exchange information with ministry departments involved in partnership activities;

- communicate with the Auditor General of BC to co-ordinate P3 related audit activity to avoid duplication;

- continue to provide core consulting and advisory services but not commit resources to building its capacity to offer additional specialized P3 consulting and advisory services to ministries;

- continue to develop its capacity to provide traditional internal audit services related to P3s;

- whenever possible take a proactive forward-looking approach to its provision of P3 related audit services;

- focus its P3 related internal audit activities to those areas providing the highest potential value added to clients as set out in Figure 13; and

- work with ministries to ensure that all significant P3s are included in their Enterprise-wide Risk Management plans.
1.0 Introduction

Governments around the world are using Public-Private Partnerships (P3s) and the Provincial government has indicated its support of developing such partnerships in BC. The most common types of P3 to date have been in the area of infrastructure construction and operation and facilities construction. Another growing area for P3s is information and communications technology associated with e-government. However, few governments have yet to enter into P3s in the social policy area. (Langford, pg. 3)

In March 2002 the BC Ministry of Finance issued its Introduction to Public-Private Partnerships to provide an overview of P3s and why the government of BC and the private sector are interested in them. The government expects that involving the private sector through P3s it will create opportunities to:

- improve service delivery through greater flexibility, innovation and competitiveness;
- obtain private sector investment in public sector infrastructure to help bridge the gap between the need for provincial infrastructure and the province” financial capacity;
- use P3s as vehicles for systems of service delivery based on user-pay where the direct beneficiaries of a service will cover some of its costs; and
- develop a P3 industry in BC to enable the private sector to gain experience and expertise in P3s that can be exported. (MFIN, pg. 2)
On May 30, 2002 the Minister of Finance announced the formation of a new agency, Partnerships BC, to aid in the delivery of public capital projects using P3s. In conjunction, a new Capital Asset Management Framework that provides guidelines and rules for new capital projects was also issued.

The ministries of Transportation and Sustainable Resource Management have already established internal P3 or Partnership branches to facilitate P3 and Alternate Service Delivery Projects. Other ministries such as Health and Education are also actively exploring such partnership opportunities.

In anticipation of client demand for audit services and advice related to Public-Private Partnerships Internal Audit & Advisory Services (IAAS) is developing its capacity to deliver such services and advice.

Purpose

The purpose of this project is to contribute to the development of the branch’s internal capacity to deliver P3 related audit and advisory services.

Objectives

Specific objectives of the review are to:

- build general knowledge about, and expertise in Public-Private Partnerships within IAAS;
- identify and explore areas where IAAS could provide value added services in assisting client ministries in achieving their P3 objectives;
compile a general-purpose reference document and audit tools to help IAAS staff plan and undertake P3 related internal audit projects; and

meet the requirements of the Masters in Public Administration (MPA) management project.

Methodology/Approach

The primary approach of the project included researching and reviewing literature on P3 theory, policies, guidance and practices of:

- the BC government;
- other public sector jurisdictions (for example, Federal Government of Canada, other provinces, the UK, the USA, and Australia);
- academic literature; and
- private sector organizations;

and adapting the research findings and best practices to the specific needs of the IAAS.

Report Structure

The report contains four main sections: Understanding P3s; Jurisdictional Review; Role of IAAS; and Tools and Frameworks. The first section summarizes some of the more significant aspects and characteristics of P3s to provide the reader with a basic understanding of P3s. The second section examines and summarizes P3 audit related services being provided or conducted in other jurisdictions. The third section examines how best IAAS may provide value-added services within government for its clients. The final section provides some basic audit tools and frameworks that IAAS staff can utilize when planning and conducting P3 related audits, reviews or advisory services.
2.0 Understanding Public-Private Partnerships

Public-Private Partnerships are not new. They have been in use for over two decades. P3s have been implemented in at least twenty-five countries and by all the Canadian Provinces. (Allan, pg.1) There is already a vast amount of literature related to P3s: what they are; guidelines, best practices, benefits, etc. The purpose of this section is to consolidate the significant aspects of the literature to provide IAAS management and staff with an overview of P3s - What they are and are not; the types of P3s; their purported benefits; best management practices; and common risks associated with P3s.

2.1 What are P3s

Recently the term P3 has become politically popular. In discussions on alternate service delivery (ASD) the term partnership or P3 is widely and imprecisely used to describe any working relationship between the public and private sectors including common contract-for-service relationships (Rodal/Mulder, pg 27 and Langford, pg.2). However, consultation, privatization of government owned businesses, devolution, and the contracting out of public sector activities are not P3s. Thus a P3 is a form of ASD however; ASD is not necessarily always a P3.

Two commonly used definitions of P3s are presented here.

1. The Canadian Council for Public-Private Partnerships defines a P3 as: "a co-operative venture between the public and private sector partners built on the expertise of each partner that best meets clearly defined public needs through the appropriate allocation of resources, risks and rewards."
2. Alternatively Rodal and Mulder define a partnership as an arrangement between two or more parties who have agreed to work co-operatively toward shared and/or compatible objectives and in which there is:

- shared authority and responsibility (for the delivery of programs and services, in carrying out a given action or in policy development);

- joint investment of resources (time, work, funding, material, expertise, information);

- shared liability or risk taking; and

- ideally mutual benefits. (Rodal/Mulder, pg. 28)

The BC Ministry of Finance suggests a narrower definition of P3s as contractual arrangements between the public and private sectors for the provision of assets and the delivery of services that have traditionally been provided by the public sector. (MFIN, pg. 1) Consistent with the Provincial Government’s focus on P3s for infrastructure construction and operation this definition stresses a contractual relationship. However, such a strict contractual relationship is not necessarily a defining criterion of a P3. For example, many collaborative partnerships such as strategic alliances, used in the private sector to avoid the complexities of vertical integration and merger, are not controlled by contractual relationships but rather by a voluntary convergence of organizational culture, structures and processes. (Langford, pg. 4)

No matter what definition is used, the central feature of any P3 is multi-year collaboration between a public and one or more private organizations towards the concurrent fulfillment of public policy objectives and the goals of the private partners. This implies
sharing of such things as vision, authority, information, planning, decision-making, financial risk, responsibility and accountability. (Langford, pg. 2)

2.2 Types of P3s

There are a wide variety of partnership types. It can be hard not to be overwhelmed by the number and diversity of P3s. (Lindquist, pg. 23) Therefore, it is often beneficial to categorize P3s by particular aspects of the partnerships that will be of greatest relevance to management or audit organization. For example, governance and accountability is of greater significance for P3s with greater partner interaction such as collaborative partnerships than for consultative partnerships (see Figure 1). Classifying P3s can also aid in creating common frameworks for assessing the success or suitability of the various types of P3s. (Rodal/Mulder, pg. 32) P3s may be classified using a number of different dimensions such as:

- the degree of risk transfer; (Allan)
- outcomes; (Treasury Board Secretariat)
- purposes or objectives, such as to increase responsiveness, effectiveness, risk sharing, cost efficiency; (Rodal/Mulder)
- by activity undertaken such as policy development, program design, program delivery; (Rodal/Mulder)
- mechanisms involved such as voluntary alliances, project specific agreements, contractual relationships; (Rodal/Mulder)
partner interactions such as consultation, advisory, operational, collaboration; (Rodal/Mulder and Kernaghan) and financing and cost recovery methods. (PFI, UK)

Two common methods to classify P3s are by level of partner interactions or by risk transfer.

Rodal and Mulder provide four broad categories for classifying P3s by partner interaction: consultative, contributory, operational and collaborative. Figure 1 describes the general purpose and the associated level of partner interaction for each category. (Rodal/Mulder, pg. 29)

Figure 1: Classification of P3s by level of partner interaction

<table>
<thead>
<tr>
<th>Type of P3</th>
<th>Purpose</th>
<th>Level of Partner interaction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consultative</td>
<td>Advisory – To obtain input into policy, strategies and program design and delivery.</td>
<td>The government maintains control, ownership and risk with input from clients and stakeholders.</td>
</tr>
<tr>
<td>Contributory</td>
<td>Support-sharing – To leverage resources for program delivery.</td>
<td>The government retains control, but partner-contributors agree to objectives and share in some of the ownership and risk.</td>
</tr>
<tr>
<td>Operational</td>
<td>Work-sharing – To allow for a sharing of resources and work and exchange information for program delivery.</td>
<td>Government retains control, but partners can influence decision-making and share ownership and risk.</td>
</tr>
<tr>
<td>Collaborative</td>
<td>Decision-making – To promote joint decision making in policy development, strategic planning, and program design, and delivery.</td>
<td>Control, ownership and risk are all shared.</td>
</tr>
</tbody>
</table>

(Source: Rodal and Mulder, pg 36)

The Canadian Council for Public-Private Partnerships and the B.C. Taskforce on Public-Private Partnerships both use a system of classifying P3s based on risk transfer that is commonly used for infrastructure projects. This approach orders P3s on a scale reflecting the degree of risk transferred from the public sector to the
private sector. Infrastructure P3s generally may include some combination of the following functions: Design (D); Build (B); Finance (F); Operate (O); Maintain (M); Own (O); Transfer (T); Lease (L); Develop (D); and Buy (B). (Allan, pg. 11) Common combinations of functions and their order on the risk-transfer scale are shown in Figure 2. Such a classification method would also be a way for the Ministry of Transportation to classify its P3 projects.

The amount of risk transferred from the public sector, and assumed by the private sector increase as one moves down the scale. At the top end of the scale is a simple contribution contract, which involves a private-sector contribution to a public facility, and minimal risk-transfer to the private sector. At the bottom end of the scale is a buy-build-operate partnership where the private partner purchases an existing public facility, upgrades it, and owns and operates it in perpetuity, assuming all the risks previously borne by the public sector. (Allan, pg. 11)

**Figure 2: Public-Private Partnerships and the Risk-Transfer Continuum**

<table>
<thead>
<tr>
<th>Risk Transferred to the Private Sector</th>
<th>Type of P3</th>
</tr>
</thead>
<tbody>
<tr>
<td>· Contribution Contract</td>
<td>· Operation and Maintenance Contract</td>
</tr>
<tr>
<td>· Design, Build</td>
<td>· Design, Build</td>
</tr>
<tr>
<td>· Design, Build, Major Maintenance</td>
<td>· Design, Build, Operate (Super Turnkey)</td>
</tr>
<tr>
<td>· Lease, Develop, Operate</td>
<td>· Lease, Develop, Operate</td>
</tr>
<tr>
<td>· Build, Lease, Operate, Transfer</td>
<td>· Build, Transfer, Operate</td>
</tr>
<tr>
<td>· Build, Transfer, Operate</td>
<td>· Build, Own, Transfer</td>
</tr>
<tr>
<td>· Build, Own, Operate, Transfer</td>
<td>· Build, Own, Operate, Transfer</td>
</tr>
<tr>
<td>· Build, Own, Operate</td>
<td>· Build, Own, Operate</td>
</tr>
<tr>
<td>· Transfer to Quasi-public Authority</td>
<td>· Transfer to Quasi-public Authority</td>
</tr>
<tr>
<td>· Buy, Build, Operate</td>
<td>· Buy, Build, Operate</td>
</tr>
</tbody>
</table>

(Source: Allan, pg. 11)
The Ministry of Sustainable Resource Management, in its Partnership Management Framework, has developed their own method of classifying partnerships based on a combination distinguishing features, authority, benefits, and risk. Not all partnerships as defined by MSRM are P3s as defined for IAAS. The classification system used by MSRM encompasses a range of alternate service delivery arrangements including P3s.

The ministry has defined three groups of partnerships as illustrated in Figure 3. Type A partnerships are described as typically a method for business continuation through alternative funding. Type A partnerships are limited by delegated spending authority levels and are intended to empower staff to pursue partnerships as a means to achieve cost-recoveries, or reduce or avoid costs in their respective business areas.

A shift in control over program policy, design, and accountability characterize Type B partnerships. A greater degree of executive involvement is required in these partnerships to ensure consistency and to assess the applicability of such arrangements to other areas of the ministry. Type C partnerships represent key ministry initiatives and will be led by the Partnership Branch.
Figure 3: MSRM Partnership Types

<table>
<thead>
<tr>
<th>Distinguishing Features</th>
<th>TYPE A</th>
<th>TYPE B</th>
<th>TYPE C</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost Recovery or Status Quo</td>
<td>Shared Power and Risk</td>
<td>Strategic Direction, Business Issues</td>
<td></td>
</tr>
<tr>
<td>Authority</td>
<td>Bottom-up Spending Authority</td>
<td>Bottom-up Sr. Mgmt./Executive</td>
<td>Top-down Executive Decision</td>
</tr>
<tr>
<td>Accrued Benefit</td>
<td>Retained at Initiating Dept./Div. Level</td>
<td>Retained at Initiating Dept./Div. Level</td>
<td>Retained at Ministry Level by Executive</td>
</tr>
</tbody>
</table>

(Source: Partnership Branch, pg. 8)

UK Models

In a United Kingdom report Public Private Partnerships - The Government's Approach, a set of eight partnership categories is used to group P3s by type. The types of P3s presented range from Asset Sales through to Policy Partnerships. The framework provides a definition of each category as well as the opportunity they present and the challenges they bring. The various categories of P3s will not be discussed in detail here but a summary of the framework is provided as Appendix 1.

Dimensions of P3s

No single method of classifying P3s provides relevant or useful information in all cases. For example, a classification of P3s based on the level of risk transfer may not tell anything about the expected level of partner interaction within each classification group. Alternatively, a classification of P3s based on partner interaction does not mean the P3s in each group will have similar purposes and objectives. Therefore, auditors should be prepared to evaluate the suitability of each method of classification in relation to possible audit objectives and the P3 attributes they are most interested in assessing, and select the most appropriate one on a case-by-case basis.
There are also differing audit and management implications for the various types of partnerships. Areas of risk and selection of appropriate audit objectives will often be impacted by the significant attributes of the P3 such as the degree of risk transfer or partner interaction involved. In other words, some risks will be greater and some audit objectives more important for some forms of P3s than for others. Take protection of the public interest and value for money for example, risks associated with these principles are often more significant for P3s with a high level of risk transfer to the private sector. Similarly, risks associated with the principles of governance and accountability are generally of more significance for collaborative partnerships with high levels of shared decision-making.

Other attributes of P3s such as objectives or partners may also affect the risk areas and the focus of audit activity. For example, P3s with broad based social objectives and a number of partners will have different risks, than infrastructure projects with limited objectives and less partners.

In practice the distinctions between the various types of P3s and other alternate service delivery methods can be unclear and therefore, they are not always easily classified. New types of P3s are continually being developed as new opportunities are identified and innovative solutions sought. Rodal and Mulder provide a useful diagram for determining the why, what, with whom, and how dimensions of P3s. The diagram is provided here as Figure 4 and can be applied during audit planning to help scope potential projects. By answering questions related to a P3’s purpose, objectives, activities, partners and mechanisms auditors can gain a basic understanding of the main dimensions of the P3 to classify it, assess significant risks and develop audit objectives and criteria.
### Figure 4: The dimensions of P3s

<table>
<thead>
<tr>
<th>Why? (Purpose/objectives)</th>
<th>What? (Activity)</th>
</tr>
</thead>
<tbody>
<tr>
<td>To reduce cost to government</td>
<td>For information exchange</td>
</tr>
<tr>
<td>To improve service/responsiveness</td>
<td>For research</td>
</tr>
<tr>
<td>To empower clients</td>
<td>For marketing</td>
</tr>
<tr>
<td>To improve effectiveness</td>
<td>For policy development</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>With whom? (Partners)</th>
<th>How? (Mechanisms)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Client groups</td>
<td>Informal, personal, voluntary arrangements</td>
</tr>
<tr>
<td>Not for Profits groups such as volunteer associations, community groups</td>
<td>Binding legal agreements</td>
</tr>
<tr>
<td>SUCH sector organizations such as school boards, universities.</td>
<td>Short-term – project specific agreements</td>
</tr>
<tr>
<td>First Nations</td>
<td>Long-term – wide scope agreements</td>
</tr>
<tr>
<td>Business, industry</td>
<td>Cost, revenue or work sharing</td>
</tr>
</tbody>
</table>

(Source: Rodal/Mulder, pg. 33)

For some examples of actual P3s, four case studies are presented in appendix 2. Other examples of P3s are included in the Ministry of Finance’s, An Introduction to Public-Private Partnerships that can be accessed through the ministry’s website.

### 2.3 Benefits of P3s

Gaining an understanding of the purported benefits of P3s is important to auditors when evaluating P3s. Although the purported benefits may not always be explicitly stated as objectives, assessing the achievement of the implicit benefits is important to determining the rationale for, and success of, the P3.

Government may enter into partnerships for a variety of purposes and to achieve a number of objectives. Proponents of P3s cite a number of reasons or benefits for using them. For example, P3s are promoted as ways to reduce government cost, improve service, build on private sector expertise, promote innovation, leverage
resources, and promote economic development. The Private Finance Panel in the UK notes that by exploiting private sector management, commercial, and creative skills, P3s should provide quality services at costs lower than through traditional methods of procurement and delivery. (HM Treasury, pg. 4)

In BC the Ministry of Finance sees P3s as providing the potential for:

- better value for money through the provision of prescribed service levels at less cost than traditional methods;
- quality improvements in service delivery;
- delivering projects faster than traditional means;
- generating more funds to deliver other needed services through saving;
- greater budget certainty for government by transferring project development and operating risks to the private sector;
- greater utilization of facilities, increased service levels and availability through incentives to private sector partners to increase their return on investment; and
- improved efficiency and project economics through competition. (MFIN, pg. 2)

The ministries of health, education and transportation are all promoting P3s as a way to meet infrastructure needs with limited resources. The Ministry of Transportation sees P3s as "a way of capturing the innovation, talent and expertise of the private sector, to develop creative solutions to help meet public priorities, and obtain the best value for tax dollars." P3s are seen as offering the potential for a number of benefits over traditional methods of providing transportation infrastructure including:
• reduced costs to the taxpayer;

• lower public debt;

• more infrastructure projects started sooner and completed faster;

• innovation in design and construction;

• better use of land and resources; and

• better management of risk. (MOT, pg. 9).

Other ministries such as Sustainable Resource Management are promoting P3s as a way to reduce operating costs and streamline services. Generally ministry objectives in pursuing P3s are the same as for other program or project methods to provide more responsive service to clients and stakeholders, and do things more effectively and efficiently. P3s are seen as a way to contribute to the achievement of these broad objectives by:

• enhancing commercial opportunities;

• increasing interactions with clients and stakeholder groups;

• allowing for greater empowerment of clients and stakeholders;

• improving coordination and information exchange;

• accessing a broader base of expertise and knowledge;

• providing for greater flexibility and innovation; and

• pooling or sharing risks, costs, and infrastructure. (Rodal/Mulder, pg. 31)
Fitzsimmons in his article for the Institute of Chartered Accountants of BC lists three major benefits to government of using P3s:

- to provide an alternative source of financing;
- more effective program/project delivery; and
- to protect taxpayers from the costs of project failures.
  (Fitzsimmons, pg. 8)

Generally the two most common benefits expected from P3s and therefore used as rationale for pursuing a partnership are leveraging resources and reducing costs (i.e., value for money). A lack of resources is a primary force driving governments all over to pursue P3s. It is more and more difficult for the public sector to maintain existing infrastructure and develop needed new infrastructure using only public funds. In addition, there is pressure to reduce expenditures while at the same time continuing to provide needed services. P3s are therefore seen as a way of generating the extra resources needed to allow infrastructure projects to be completed or services to be provided that could not otherwise be funded by government alone. Involving the private sector through P3s can provide the substantial investment needed.

Appropriate risk allocation, innovation and incentives are key contributors to value for money for the P3 projects. Simply transferring risk does not in and of itself lead to reduced costs. It is the effective management of risk that leads to savings. Risks must be appropriately transferred to the party that can most effectively manage the risks thereby reducing overall costs. (OAG-UK(a), pg. 52) For some risks this may be the private sector partner while for others it may be the public sector.
Take for example, the maintenance risk commonly associated with the operation of a facility. This is the risk that the design and/or construction quality is inadequate resulting in higher than anticipated maintenance costs. For a facility operated directly by the public sector this risk can result in increasing costs to government over the life of the facility. However, by allocating this risk to the private partner through a DBO type P3 where the private partner is responsible for the design, construction and operation of the facility, the private partner is better able to manage the risks and costs to government are reduced.

P3s can also increase the scope of innovation and incentives not possible through traditional methods, which can increase efficiency, lower operating costs, and enhance customer service.

Allan in his review of P3 literature and practice lists eight potential benefits that can accrue from P3s. These benefits, summarized in Figure 5 will not be present in all P3s, but individual benefits or combinations of them are the primary rationale for entering into a P3 over a more traditional form of procurement or service delivery.
Figure 5: Summary of Potential Benefits from P3s

<table>
<thead>
<tr>
<th>Potential Benefit</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Leveraging of public funds</strong></td>
<td>By serving as a vehicle for the injection of private-sector financing, P3s can augment the resources available for the provision of public goods and services. The added financing can provide for projects to proceed when public finances are not available.</td>
</tr>
<tr>
<td><strong>Better management and allocation of risk</strong></td>
<td>P3s typically involve the formal identification, quantification, and allocation of risk among the partners. Since risk is a real project cost, this structured approach to its management is likely to result in greater economic efficiency than in traditional public-sector procurement, in which risk is frequently ignored as an element of cost. P3s also allow particular risks to be allocated to the partner best able to manage them, thereby reducing risk management costs of projects.</td>
</tr>
<tr>
<td><strong>Incentives to perform</strong></td>
<td>P3s often contain incentives to perform such as where payment is conditional on the quality of service or completion of a project. Additionally, the private sector typically has a wider range of performance based remuneration options available to enhance performance not available to the public sector.</td>
</tr>
<tr>
<td><strong>Improved effectiveness</strong></td>
<td>P3s facilitate the co-ordination of efforts and systems and typically provide a broader base of expertise. Additionally, partners who are free from bureaucratic “red tape” and isolated from political intervention may be able to operate more flexibly and effectively than a government department or agency.</td>
</tr>
<tr>
<td><strong>Alternative revenue sources</strong></td>
<td>P3s may serve as vehicles to introduce tolls or other user-charge systems, while still permitting government to distance itself from these developments. By accessing revenues from third parties, a P3 may be able to undertake projects that the government would not.</td>
</tr>
<tr>
<td><strong>Access to economies of scale or scope</strong></td>
<td>A private-sector partner may undertake the activities required of them in the P3 for other clients or partners. The resulting scale of their total operations may therefore be considerably greater than the scale of the partnership. This may permit them to maintain and make available to the P3 highly specialised expertise of a sort that would be uneconomic were the P3 project considered in isolation.</td>
</tr>
<tr>
<td><strong>Encouragement of multi-use infrastructure</strong></td>
<td>A private-sector partner in a P3 may have incentives to attract secondary users, possibly in the form of ancillary commercial development, thereby stimulating more intensive usage of the partnership capital assets.</td>
</tr>
<tr>
<td><strong>Improved service responsiveness</strong></td>
<td>P3s can be useful vehicles for increasing interaction and familiarity with clients, thereby permitting government to better determine, understand, and meet their needs.</td>
</tr>
</tbody>
</table>

(Source: Allan, pg. 2)
The benefits of P3s are not universally accepted. Groups such as public sector unions as well as experts such as Ron Parks, CA-IFA openly dispute the benefits of P3s. Mr. Parks, a well-known forensic accountant believes that P3s provide very little benefit that well-planned and managed public sector projects could not provide. (Fitzsimmons, pg. 9)

Auditors should question the veracity of the arguments supporting the projected benefits of P3s. Wide sweeping statements such as that the private sector can in most cases deliver government programs more effectively than the public sector should not be accepted at face value. While there is evidence to show that in the UK infrastructure projects completed under P3s have produced average savings of 17% over traditional procurement methods (Fitzsimmons, pg. 9), such savings have not yet been demonstrated for social program P3s. Experience has also shown that for most projects or programs undertaken to address a major public need, it is always the public sector that retains the risk if the project or private partner fail. Therefore, where protecting the taxpayer from the costs of failure is a benefit sought through a P3 it is often not achievable.

2.4 P3 Life Cycle

The life-cycle phase of a P3 can drive the extent and nature of internal audit involvement. Therefore, it is important for internal auditors to both understand the different phases of a P3 life cycle and be able to identify them. There are a number of models that can be used to depict the life-cycle phases of a P3. Most are similar and include planning, implementation, operation, and wind-up phases. Life cycle models are commonly used as the framework within which most guidance materials for prepared
management set out the various steps to be followed. One model is presented here to familiarize auditors with their structure and content so that they can better identify and understand the phases of a P3.

KPMG in its draft internal audit and management guides uses a four-phase life cycle model: Decision Stage; Development and Approval; Operations; and Wind-up and /or Renewal. (KPMG (b), pg. 8) Figure 6 illustrates a typical five phase P3 life cycle with high level steps or activities involved in each phase. Because of their importance to the success of a P3, project development and implementation, included in the operations phase in the KPMG model are shown here as a separate phase.

**Figure 6: Typical P3 life cycle model**

<table>
<thead>
<tr>
<th>Phase</th>
<th>High Level Step</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pre planning and Decision Stage</td>
<td>1. Strategic analysis and identify needs</td>
</tr>
<tr>
<td></td>
<td>2. Analysis of Opportunities</td>
</tr>
<tr>
<td>Planning, Development and Approval</td>
<td>3. Business case analysis</td>
</tr>
<tr>
<td></td>
<td>4. Identification and selection of P3 partner</td>
</tr>
<tr>
<td>Project development and Implementation</td>
<td>5. Final negotiations with selected partner</td>
</tr>
<tr>
<td></td>
<td>6. Implementation of P3</td>
</tr>
<tr>
<td>Operations and Partnership Management</td>
<td>7. Ongoing partnership management, performance monitoring and evaluation</td>
</tr>
<tr>
<td></td>
<td>8. Learning, modification and improvement</td>
</tr>
<tr>
<td>Wind-up or Renewal</td>
<td>9. Completion and Continuation</td>
</tr>
</tbody>
</table>

(Source: KPMG (b), pg. 8)

**Phase 1 - Pre planning and Decision**

The strategic analysis is a formal high level review and risk analysis of the services that the ministry currently provides. The objectives of this phase are to determine which services are of core importance, identify the significant risks associated with those...
services, and explore possible P3 opportunities. (KPMG (a), pg. 17)
These processes would normally be performed annually during the
ministry's Service Plan and Enterprise-wide Risk Management
activities.

Identify Needs

The identification of needs is a normal part of program planning.
Whether provided directly by ministries or through a P3, ministries
are responsible for delivering particular outputs to achieve
outcomes required by government. Therefore the proper
identification of outputs necessary for achieving particular
outcomes is of fundamental importance. At this stage it is also
important that project/program objectives be specified. Objectives
should be clear and specific while at the same time being broad
enough to allow for changes to service needs as they are further
refined during the development of the P3. (Partnerships Victoria
(b), pg. 15)

Analysis of Opportunities

At this stage an initial analysis of P3 opportunities is undertaken.
Such an analysis would normally include assessing the
opportunities against some pre-established criteria such as:

- Is the opportunity likely to provide value for money?

- Is it likely the net benefits of the opportunity will exceed the
transaction and other costs to the ministry and the private
sector partners?

- Can the outputs be specified in clear and measurable terms
around which a payment mechanism can be structured?

- Is there opportunity for risk allocation to the private sector?

- Is there a level of market interest that would make the
opportunity commercially viable?
If the opportunity meets at least these criteria then the ministry would move forward to the next phase, if not other options should be explored. (Partnerships Victoria, (b), pg.18)

**Phase 2 - Planning, Development and Approval**

A business case analysis provides a thorough review of the P3 opportunity. It is a very important step in the planning and decision-making process and is designed to provide information on the likely financial and business consequences of undertaking the P3. The business case should not be viewed as a way to justify the proposed P3 but as a detailed analysis of the quantitative and qualitative factors, both positive and negative impacting the opportunity. The Ministry of Sustainable Resources in its Partnership Management Framework provides a good template to guide management in preparing a business case for decision making.

Identification and selection of a partner involves planning the selection process through selecting the best partner. The purpose is to choose a partner or partners that best meet the key criteria seen as needed to ensure the success of the P3. Partners are usually selected based on the results of a Request for Proposals (RFP) process.

Preparation of proposals for P3s is very costly and time consuming for potential private sector partners, therefore prior to issuing an RFP the ministry may take steps to identify potential partners capable of providing the required outputs through a Request for Expressions of Interest (REI). The REI is used to identify and narrow the number of potential proponents to those interested and potentially capable of partnering with the ministry. To help ensure a competitive process and value for money the REI should be
publicly advertised. A mechanism such as BC Bid should be used in order to reach the widest possible market of potential private sector partners.

Because the costs of preparing and evaluating P3 proposals can be significant narrowing the number of proposals can save costs. If a REI is used prior to the RFP then the RFP can be selectively issued to those parties identified during the REI.

Specific criteria associated with the ministry's needs are designed against which proponents can be evaluated. It is important that the criteria and any technical or performance specifications be clearly stated in the RFP so the ministry can receive the best proposals. Once proposals are received they are evaluated against the criteria included in the RFP to determine the best potential partner or partners. A team should conduct evaluations of P3 proposals and processes should be in place to ensure that the evaluation is fair. Independent auditors are often involved in the Identification and selection of a partner stage to ensure and attest to the fairness of the process.

**Phase 3 - Project development and Implementation**

Unlike for traditional RFPs where the best proposal is offered a contract, establishing a P3 often required substantial negotiation with potential partners after the proposals have been evaluated. Once a preferred proposal or proposals has been recommended, the ministry may conduct contract negotiations. Negotiations may be held with more than one of the proponents to maintain competition. During the negotiation stage legal and other expert advisors are usually involved. It is important that a negotiation framework is established to ensure the continued fairness of the process. Independent auditors are also often involved in the during the negotiation stage to ensure and attest to the fairness of the process.
Implementation

The implementation stage of a P3 is usually considered high risk. Moving to a P3 arrangement involves change and uncertainty within the ministry. It is therefore important that roles and responsibilities of each party be clearly established and communicated. It is also important for the ministry to manage the risks during this stage. Some of the risks commonly associated with implementation of a P3 requiring management include:

- a lack of flexibility to meet new and changing requirements;
- labour disruptions, low staff morale and a loss of productivity;
- loss of operational control; and
- loss of service continuity. (KPMG (a), pg. 25-26)

Phase 4 - Operations and Partnership Management

The operation stage of a P3 starts from the establishment of the partnership where the partners are developing trust and comfort with each other and evolves to a stable mature relationship. Performance monitoring and evaluation are critical to managing a successful P3. Guidelines and processes should be established to provide for ongoing monitoring of performance during a P3. Mechanisms should also be in place to ensure the partners work together to learn, modify and improve relationships and the operations of the P3 over time based on the results of their monitoring and evaluations activities. As with any government program the performance of a P3 and compliance by both partners with the P3 agreement will be subject to audit. The right to access information and audit a P3 should be included in the agreement.
**Phase 5 - Wind-up or Renewal**

The final phase of a P3 is its completion or continuation at the end of the term or concession period. This stage usually involves a final assessment of the P3 and a decision to wind it up or renew it. As most P3 arrangements are long term, often 30 years or more, not many provincial P3s will be in this phase for quite some time.

**2.5 Common Risks**

An understanding of the risks associated with P3s is key to providing effective value added internal audits, reviews and advice. As discussed in section 2.3, P3s are meant to provide a number of significant benefits, but they are not guaranteed. The other side of any potential benefit is risk. To illustrate, figure 7 describes some of the risks associated with the potential benefits of P3s as described by Dr. Allan. The risks shown are by no means all the possible risks associated with each potential benefit but provide an example.

The identification and assessment of risks and their controls are key to any effective P3 review or audit. Risk can be defined as the chance of an event happening that will have an impact on the achievement of objectives and is measured in terms of consequences (impact) and likelihood (probability). The Canadian Institute of Chartered Accountants defines control as those elements of organization (including its resources, systems, processes, culture, structure and tasks) that taken together, support people in the achievement of the organization's objectives. (CICA, pg. 2)
### Figure 7: Examples of risks associated with benefits of P3s

<table>
<thead>
<tr>
<th>Benefit</th>
<th>Risk</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Leveraging of public funds</td>
<td>Financing Cost Risk</td>
<td>The risk that P3 financing costs may be higher when the private sector has to provide their own financing adversely affecting value for money. For example, the Auditor General of Canada found that the financing costs for the Northumberland Strait Crossing Project (NSCP) could have been reduced by $45 million if government had raised the debt through its own borrowing program.</td>
</tr>
<tr>
<td></td>
<td>Inappropriate Accounting Treatment</td>
<td>The risk that aggressive accounting practices and P3 financing arrangements are used to inappropriately move P3 projects off the government's balance sheet adversely impacting transparency and accountability. For example, during the audit of the NSCP the Auditor General also found that the financial arrangements were complex and a departure from usual practices and that government had not been recording the liability on the balance sheet.</td>
</tr>
<tr>
<td>Better management and allocation of risk</td>
<td>Inappropriate Transfer</td>
<td>The risk that operational risks are not appropriately transferred to the party that can most effectively manage the risks adversely impacting on value for money.</td>
</tr>
<tr>
<td>Incentives to perform</td>
<td>Misalignment of Incentives</td>
<td>The risk the incentives to perform are not appropriately aligned with P3 goals and objectives resulting in unintended consequences.</td>
</tr>
<tr>
<td></td>
<td>Lack of Incentives</td>
<td>The risk that the P3 arrangement lacks sufficient incentives adversely impacting value for money and service quality.</td>
</tr>
<tr>
<td>Improved effectiveness</td>
<td>Inappropriate Innovation</td>
<td>The risk that private sector partners by being flexible and innovative to increase effectiveness do not maintain key public sector values such as transparency, fairness, equity, health and safety, environmental protection, competition.</td>
</tr>
<tr>
<td></td>
<td>Lack of co-ordination</td>
<td>The risk that a lack of co-ordination of efforts and systems between partners adversely impacting the effectiveness of the P3.</td>
</tr>
<tr>
<td></td>
<td>Lack of Communications</td>
<td>The risk that the parties to the P3 may not be communicating effectively with each other. As a result, partners may not have common understanding of expectations, roles and responsibilities leading to misunderstanding and loss of trust.</td>
</tr>
<tr>
<td></td>
<td>Lack of Accountability</td>
<td>The risk that an appropriate accountability framework and performance measures are not in place. As a result, partners are not being held accountable for performance of the P3.</td>
</tr>
<tr>
<td>Alternative revenue sources</td>
<td>Risk Benefit</td>
<td>The risk of an imbalance between shared benefits and risk. As a result one partner may not be committed to the partnership because they perceive the risks assumed do not equal the benefits.</td>
</tr>
<tr>
<td></td>
<td>Inappropriate Revenue Sources</td>
<td>The risk that tolls or other user-charge systems are not equitable, fair or in the public interest resulting in unintended consequences.</td>
</tr>
<tr>
<td>Encouragement of multi-use infrastructure</td>
<td>Conflicting Objectives</td>
<td>The risk that incentives to attract secondary users, possibly in the form of ancillary commercial development, result in conflicting or competing objectives between primary and secondary users.</td>
</tr>
<tr>
<td>Improved service responsiveness</td>
<td>Lack of Interaction with clients</td>
<td>The risk that processes are not in place to ensure that adequate interaction and familiarity with clients occurs. As a result, client needs are not determined, understood, or met by the P3.</td>
</tr>
</tbody>
</table>

(Source: Allan, pg. 2)
The major risks that can adversely impact a P3 are for the most part, similar to those for any other public sector program or project. However, because of the horizontal partnership nature of P3s and the involvement of the private sector in the delivery of public services some risks are more significant for P3s than for traditional public sector programs or projects. For example, a lack of: clear roles, responsibility and accountability; common objectives, values and principles; competition and transparency; stewardship of public assets; performance reporting and access to information; regular communications; and loss of public sector expertise to name a few.

Given the diversity of P3s, it is difficult to be exhaustive regarding the risks they may involve. At the risk of oversimplifying most risks can be classified into two broad categories based on the public sector principle they impact. For P3s the two principles are protection of the public interest and value for money. As will be discussed in section 3.0, to date these two principles have been the main areas of P3s examined by various audit organizations in other jurisdictions.

**Protection of the Public Interest**

Risks that can impact on the public interest should be considered throughout the P3 life cycle. In general protection of the public interest is best ensured through the achievement of P3 objectives in a manner consistent with public sector values and principles. A focus on results, while providing the flexibility required for innovation and efficient operations cannot ignore the need to achieve those results within a framework of values and principles expected of the public sector.
Some of the main areas of risk associated with protection of the public interest include: governance and accountability; equity and fairness; transparency; conflict of interest; stewardship of public assets; public health and safety; environmental protection; and security.

The lack of an appropriate governance and accountability framework is a significant risk related to P3s. Appropriate governance and accountability structures are essential in ensuring protection of the public interest. Regardless of the P3 structure or the terms of the contract, ministries cannot transfer to the private partner their responsibility and accountability to the public for the delivery of services that they are legally obligated to deliver or which they have undertaken to provide to the public. (Partnerships Victoria (a), pg. 9) The Auditor General of Saskatchewan also concluded that in order to adequately protect the public interest entities created by P3 agreements must be regarded as part of government and held accountable to the Legislative Assembly so that the lines of public accountability are not blurred. (PAS, pg. 51)

An appropriate governance and accountability framework should include clear roles and responsibilities, balanced expectations, specific performance expectations, independent evaluation provisions, reporting requirements and dispute resolution mechanisms. The framework should also ensure that public interests are not compromised which can occur if there is insufficient allowance for public consultation or responsiveness to public needs. (Rodal/Mulder, pg. 32)
A focus on results and a private sector emphasis on efficiency and profits increases the risk that there may be a lack of equity and fairness in a process. Equity and fairness are two major public sector values. In endeavoring to achieve results as efficiently as possible and because many P3s include a user pay mechanism there is a risk that a P3 may not have sufficient controls in place to ensure the equity and fairness of its processes to clients or citizens.

There is also a risk that a lack of competition resulting from unsolicited P3 proposals will adversely impact on protection of the public interest. It is expected that ministries will receive unsolicited proposals for P3s and that they will be challenged to ensure processes for evaluating them are fair, open and transparent. The Ministry of Finance has therefore included guidance to ministries outlining the processes to be followed when unsolicited proposals are received. (MFIN, pg 11)

Transparency is a key public sector principle to provide for the protection of the public interest and is required of all P3s by government’s Capital Asset Policy. Transparency provides for public consultation, buy in from the public and accountability to the taxpayers, which can be crucial to the success of a P3. Therefore, as much information as possible should be kept in the public domain. The risk of a lack of transparency is significant for all P3s in a number of areas.

For example, many P3s involve complex financing and long-term lease arrangements. At times these arrangements are used to justify moving projects off the government’s balance sheet to hide public debt. The opportunity for such accounting treatment also increases the risk that P3s are pursued for the wrong reasons. (Fitzsimmons, pg 9)
The public interest can be compromised if disclosure of information is not consistent with government’s internal standards. (OAG Canada (c), pg. 38-39) Private sector confidentiality clauses meant to protect proprietary or competitive information can threaten the transparency of a P3. Confidentiality should not be allowed to override the need for government to be accountable for its use of public resources. Clear provisions are needed to provide for change and innovation to achieve value for money while maintaining transparency and accountability. Confidentiality clauses should be kept to a minimum. (Provincial Auditor of Saskatchewan, pg. 53) Auditors should be alert for the risks associated with confidentiality clauses in P3 arrangements and when noted ensure proper approvals have been obtained.

Through transparency all public services are accountable to the customers and communities that rely on them. Therefore access to information by government’s internal and external auditors is important to ensuring transparency. If auditors do not have the access to the information they cannot provide any assurances as to the validity and fairness of the information presented by the P3. During the project development phase there is a risk that the contract may not adequately allow for future monitoring, reporting and verification of P3 performance.

**Conflict of Interest**

Involvement of the private sector in the governance or delivery of public services to capture its expertise and innovation is one of the strengths of a P3 arrangement. However, at times the best-suited private sector partner may also be a participant in the particular program being delivered. The private sector partner could also; at times be a supplier or sub-contractor to other program participants receiving funding. In such instances the potential for perceived, or actual conflict of interest is high and auditors should be alert to such situations.
In addition there is the added risk that the private sector partner or partners may not have the same understanding of conflict of interest as the public sector. Standards of conduct in the private sector are different than those for the public sector. There is also the risk that P3s may confer special benefits or treatment to special interest groups who are better organized rather than acting in the public interest. (Rodal, pg. 51) Therefore, when planning for audits of P3s auditor should keep in mind the increased risk of conflict in such situations and ensure audit procedures address the risk.

**Stewardship of assets**

Ministries can not delegate responsibility to private sector partners and are ultimately answerable to the Legislative Assembly for their stewardship of public money. However, many P3s are structured such that the private sector partner operates or maintains government assets. As well, in some P3s the private sector partner may be responsible for the distribution of public funds to program participants. Therefore, a common risk associated with P3s is that adequate controls are not in place to safeguard public assets. These concerns emphases the importance of a comprehensive and well designed accountability framework that allows for innovation and can deliver better value for money while allowing adequate control of public funds (NAO-AU (a), pg. 35). Auditors should be aware that controls to safeguard public assets might not be as well established as for a public sector program and that additional work may necessary when assessing the financial/asset risk and controls of P3s.
P3s are often entered into to build infrastructure projects or to provide information technology services. As such there are obvious environmental protection, public health and safety and information security risks associated with most P3s that auditors should ensure are being adequately managed. The Partnership Victoria guide book, "Risk Allocation and Contractual Issues" provides detailed discussions of many of the common safety, environmental and health risks associated with infrastructure projects that would be useful to auditors when planning for audits.
(http://www.partnerships.victoria.au)

**Value for Money**

Risks that can impact on value for money should also be considered throughout the P3 life cycle. In general value for money is best ensured through the optimum allocation of risks to partners, selection of the most efficient and effective delivery arrangement, competition, innovation, and good organizational performance management. Mr. Parks sees determining value for money to the taxpayer as the single biggest challenge and risk presented by P3s. (Fitzsimmons, pg. 10)

Experience in the UK has shown that the transfer of some project risk to the private sector enhances the incentives required to promote efficiency and economy. However, it is the effective management of risk not simply the transfer of risk that leads to cost savings and some risks cannot and should not be transferred. The objective should be to achieve the optimal allocation of risks among the partners so that each risk is allocated to the partner best able to manage the risk at the least cost rather than trying to achieve the maximum transfer of risk. (Allan, pg. 14)
The allocation of risk to achieve the objective of effectively managing risk to reduce costs can be made more complicated within a public sector environment where simply maximizing the transfer of risk to the private partner may also be an objective for political reasons. Therefore, auditors should be alert to possible alternative motives behind the transfer of risk and be prepared to examine the veracity of the rationale for the transfer and question how the private sector partner is better able to manage the risk than the public sector.

The following are some examples of the types of risks that auditors should be aware of when examining the allocation of project risks of a P3 arrangement.

- The risk that too much of the project risk has been inappropriately transferred to the private sector partner. As a result, the costs of the premiums associated with managing the risks in the private sector are greater than the benefits and value for money is decreased.

- The risk that all of the significant project risks to be managed have not been identified. As a result, optimum allocation of risk has not been achieved and controls to manage the unidentified risks have not been implemented.

- The risk that the costs associated with identified project risks have not been appropriately determined and integrated into the Public Service Comparator or the cash flow analysis of the project. As a result, the P3 may not be economically feasible or may be erroneously evaluated as providing greater value for money than a traditional public sector model.
The risk that allocation of risk to partners was determined based on a desired accounting treatment for the project or other motives rather than on the basis of whom is best able to manage the risks. As a result, an optimum allocation of project risks has not been achieved increasing project costs and decreasing value for money achieved.

Given the current fiscal environment within the public services it is likely public ministries will continue to operate with limited or decreasing financial resources and will look for alternative and better ways to deliver services such as P3s. As a result, there is a risk that ministries will develop P3s to reduce costs to the ministry even though costs to government or the taxpayer are higher than for alternate service delivery structures. Also there is a risk that the public sector may opt for short-term gains or savings that may result in higher costs over the long-term. These risks may be increased even more for some infrastructure projects where private financing is used and a valid accounting treatment of the related debt can be used to move projects off the government’s balance sheet. Therefore, auditors need to stay informed of client ministry P3 activities and practices to gain assurance that analyses supporting the value for money benefits of pursuing P3s are completed with due diligence.

P3s should be pursued where it is likely to deliver better value for money than traditional delivery methods. (Partnerships Victoria (c), pg. 9) The primary method for demonstrating that a P3 option will provide value for money is through comparison of the costs of the P3 to a Public Sector Comparator (PSC). In the U.K. and Australia a PSC, which estimates the cost of the most efficient form of public sector delivery, is required to test value for money when considering P3 options. (Partnerships Victoria (c), pg. 9)
In the U.K. the PSC is defined as the hypothetical, risk-adjusted costing of the public service supplying the outputs specified as part of a procurement exercise that:

- is expressed in net present value terms;
- is based on the required output specifications; and
- takes into full account the risks which would be encountered.

(Industry Canada, pg. 11)

The main purposes of the PSC are:

- to determine if a project is affordable to government by ensuring full life cycle costing;
- as a means of testing whether a P3 is viable and demonstrates value for money;
- as a management tool during the project to communicate with partners on key aspects such as output specifications and risk allocation; and
- as a means of encouraging broader competition by creating confidence in the bidding process. (Industry Canada, pg. 11)

Each P3 project will be unique and there is no prescriptive formula that can be applied to determine value in all cases. Therefore, the amount of effort and analysis by a ministry in developing a PSC should correspond with the scale and scope of a proposed project. (Industry Canada, pg. 12) Auditors should keep this in mind and exercise professional judgement when providing assurance services or due diligence reviews of PSCs. Several months of effort is not unusual to construct a PSC for a large sized project however, the same level of effort and detail should not be expected for smaller projects.
Auditors should be aware of the risk that the PSC may not accurately estimate the full cost of traditional delivery of a project or service and that the P3 option selected will not provide value for money to government and the taxpayers. This may occur because insufficient effort and analysis was applied in constructing the PSC, the construction of the PSC was based on faulty assumptions and data, there was a calculation error, all life cycle costs were not included, or all significant risks were not taken into account. In addition, auditors should be alert to the risk of overly optimistic revenue and user projections. (Fitzsimmons, pg. 10) As a result, auditors should be familiar with PSCs and their strengths, weaknesses and best practices for compilation.

Appendix 3 provides a more in depth discussion of the PSC written by Dr. John Allan based on experiences with the PSC in the UK for those readers wanting a greater understanding of the PSC and its use. In addition PSC guidance is available for reference from jurisdictions in and outside Canada. Industry Canada has produced a 67 page Canadian Best Practices Guide on the PSC (http://www.strategis.ic.gc.ca/SSG/ce01378e.html) and Partnerships Victoria has produced a 103 page Technical Note providing detailed guidance on the construction and application of a PSC. (http://www.partnerships.vic.ga.au)

A key criterion to achieving value for money is competition. A lack of competition is therefore a significant risk to the achievement of value for money in a P3. Therefore maintaining competition is important in the planning, project development, operational phases. In the planning phase auditors need to be aware of the risk that the P3 arrangement may result in the creation of a monopoly and ensure it has been identified, assessed and controls are in place to manage the risk. During the project development phase partner
solicitation, evaluation and selection processes should provide for competition among qualified potential private sector partners to obtain the best value.

There is also a risk that a lack of competition resulting from unsolicited P3 proposals will adversely impact value for money. Therefore, processes for evaluating proposals, where there has been no competitive process need to ensure that value for money is achieved. As previously mentioned the Ministry of Finance has included guidance to ministries outlining the processes to be followed when unsolicited proposals are received. (MFIN, pg 11)

During the operations phase, if the P3 involves the private sector partner allocating public funds to sub-contractors or program participants the processes used should provide for competition and be set out in the contract.

There are a number of risks associated with managing organizational performance of a P3. For example, to deliver value for money it is vital that P3s are designed with the focus on outputs and performance. Therefore there is a risk that if P3 is too focused on inputs and processes required to protect the public interest, value for money will not be achieved. (Smith, pg. 35) Some additional risks might included that:

- measures and targets that serve to demonstrate results and provide direction for the P3 may not in place;
- results reported are not credible, accurate, fair and useful to users and in management decision-making; and
- results of the P3 are not used to assess the ongoing relevancy of the P3 and its strategies.
As can be seen these risks are similar as for any public sector program and as such should be familiar to internal auditors. However, when assessing the risks and controls for P3s auditors should look to ensure that an appropriate balance between process controls needed to protect the public interest and a focus on outputs to achieve organizational performance and value for money is has been established.

**Common risks by life cycle phase**

Each P3 will likely have its own set of unique risks depending on its goal and objectives, partners, the type of service being delivered and the structure of the arrangement or partnership itself. Therefore, when planning for an internal audit assignment the auditor must become familiar with the structure or type of the P3, the partners involved, the goal, objectives and benefits, and the operations of the P3 to fully assess the risks involved.

Figure 8 illustrates some of the potential risks that may be associated with each phase in the life cycle of a P3. Again, as with the previous figure the list of risks is by no means comprehensive and is provided primarily as an example.
**Figure 8: Examples of common P3 risks by life-cycle phase**

<table>
<thead>
<tr>
<th>Life-cycle Phase</th>
<th>Potential risks</th>
</tr>
</thead>
</table>
| Pre planning and Decision Stage               | • loss of core competencies for the ministry  
• lack of a clear understanding of strategic objectives  
• insufficient knowledge of client and stakeholder requirements  
• failure to select those services well-suited for P3 opportunities  
• insufficient understanding of the options available |
| Planning, Development and Approval            | • lack of competent external service providers  
• incomplete analysis in which not all significant factors are considered  
• poor decisions based on limited information  
• external costs of service to be delivered by private sector may be prohibitive  
• missed opportunity to use P3 |
| Project development and Implementation         | • ineffective evaluation criteria  
• lack of common understanding of the scope of work  
• evaluation not seen as an equitable process  
• disclosure of confidential information  
• inexperienced and uninformed proposal team  
• lack of a sufficient number of bidders  
• failure to properly define the roles and responsibilities of each party  
• lack of continuity of service  
• lack of flexibility of a partner to meet new and changing requirements  
• decreased staff morale  
• loss of competent employees  
• loss of productivity  
• increase in employee turnover percentage  
• labour disruptions  
• loss of operational control |
| Operations and Partnership Management         | • business failure of the private sector partner  
• inadequate confidentiality and security of information  
• failure to meet regulatory requirements  
• partner does not meet objectives  
• inefficiency by the partner or partners resulting in cost overruns  
• potential labour disputes  
• lack of corporate focus  
• lack of performance reporting  
• substandard service delivery |
| Wind-up or Renewal                             | • partner does not transfer the required information in the service  
• lack of sufficient competition for the required services once the service has been provided through a P3  
• implementing the inappropriate alternative  
• failure to meet regulatory requirements |

*(KPMG (a), pg. 17-29)*
Infrastructure Project Risks

Given current trends many of the P3s that will be undertaken will most likely be infrastructure projects. Therefore, auditors should be aware of some of the unique risks associated with such P3s. Smith provides us with a good summary of some of the major categories of risk associated with infrastructure P3s, specifically:

- design and construction risks;
- commissioning and operating risks respecting availability, operating costs, performance, and maintenance;
- demand risks relating to utilisation;
- risks respecting residual values;
- risks resulting from obsolescence or changes in technology;
- regulatory risks, including changes in taxation; and
- financing risks. (Allan, pg. 21)

These risks would normally be identified during the project development and allocated to the partner best able to manage each risk. As previously discussed, the proper allocation of these risks represents a major value for money risk. In addition, auditors should be aware that each of these risks on its own needs to be recognised and managed or each could adversely impact on the performance of a P3. Therefore auditors should be prepared to gain an understanding of infrastructure project risks and best practices for their allocation and management.
2.6 Best Practices Characteristics and Attributes

Much of what makes for successful P3s is not new to public administration. Exercising leadership, having well defined goals and objectives, extensive consulting with stakeholders, information sharing, developing trust, respecting authorities, and good accountability are some of what is required. (Lindquist, pg. 23) All of these requirements are the same for successful P3s and traditional public sector programs. However, for successful P3s more, less traditional attributes such as risk tolerance, flexibility, compatibility and a willingness to share decision-making power are also required.

To provide value added service to management of P3s internal auditors need to have a good understanding of the characteristics and attributes of successful P3s. The internal auditor to can use his or her knowledge of best practices and the characteristics of successful P3s to:

- form a basis for audit criteria against which other P3s can be assessed;
- identify risks and successful internal controls used to manage them;
- provide information that can be communicated to public sector managers to improve practices; and
- help in developing practical recommendations.

Much has been written on P3 best practices and the characteristics, attributes and principles of successful P3s. Therefore the purpose of the section is not to reproduce all that is already written but to provide an overview and highlight some of the information available to internal auditors or management to provide a basic understanding of P3 best practices.
Dr. Allan suggests that the most important factors critical to the success of P3s in general are:

- changing the culture, roles, and responsibilities within the public sector partner organization from one of being owners and operators to one of wise purchasers of long-term services;
- having specialized ministry departments involved in P3s and a central agency to provide additional expertise and co-ordinate P3 initiatives;
- providing for the early involvement of all stakeholders in each P3;
- ensuring the partners are properly accountable; and
- optimizing risk allocation by allocation of appropriate risks to the partner best able to manage them. (Allan, pg. 30-33)

Twelve best practice principles or attributes are characteristic of successful P3s, they are: risk tolerance; compatibility; shared benefits and risk taking; focus on outcomes; equitable power structure and interdependence; effective communications; adaptability; trust and respect; transparency and integrity; patience and perseverance; adequate resources; and accountability. (Rodal, pg. 60-61)
The success of P3s depends on the performance of a partner or partners, which one does not control. A key criterion to successful P3s is a high tolerance for risk and uncertainty. This is a characteristic that the public service is not commonly seen as possessing. Therefore, it is important that potential public sector partners develop a culture conducive to facilitating P3s. Such a culture fosters values of trust, collaboration, and flexibility. (Rodal, pg. 60)

In successful P3s the partners are compatible with each other. Therefore, the values, interests, goals and objectives of the partners are in line with those of the P3 and with each other. (Rodal, pg. 60) In such P3s the partners share a common vision and long-term goals. Also, structures and processes are in place to facilitate the partners in understanding each other's businesses and establishing a partnership approach based on a common vision of how they will work to achieve a mutually successful outcome. In such partnerships the agreement is approached in the spirit of a true partnership and teamwork. (OAG-UK (d), pg. 6).

Successful P3s require a commitment by the partners to working towards a goal that benefits them all. It is because of the benefits to be gained that they are willing to make a commitment and share in the risks. (Rodal, pg. 60) The commercial structure of the project must provide a viable business opportunity for private parties able and willing to manage the opportunities and risks inherent in providing the required outputs. (Partnerships Victoria (b), pg. 8)

The goal of transferring risk from the public sector to the private is to achieve an optimum allocation of risk, rather than maximizing risk transfer. P3 providing best value for money balance the risks managed by each partner with the benefits received by each.
Therefore, a best practice is to perform a thorough risk analysis to identify and clearly assign the risks to the appropriate partner. (INTOSAI supplementary guide, pg. 12). The economic implications of the risks as well as the opportunities should be considered.

To aid practitioners in allocating risks Partnerships Victoria has developed a 192 page guide which can be viewed or downloaded from their website. The primary objectives of the guide are to:

- Increase understanding of risk allocation;
- identify all major risks relevant to infrastructure projects; and
- indicate the government’s preferred position on major risks.

(Partnerships Victoria (d), pg. 3)

Reference to the guide may be beneficial to auditors tasked with assessing the due diligence of the ministry’s risk allocation processes.

The early stages of the procurement process are key to the success of the P3. A thorough definition of the project and getting the initial procurement right can reduce the need for changes, which over the life of the contract can become a significant issue. (OAG-UK (d), pg. 6) The focus should be on the outcomes that government is looking to achieve and specifying the outputs required to achieve them. How the outputs are defined will impact bidders' opportunity to be innovative in the design of the inputs. (e.g. the type of facility required, the features of the building, the types of IT infrastructure etc.) The efficiency of the bid process and quality of the result is directly related to the thoroughness of the planning of project requirements. (Partnerships Victoria (b), pg. 15)
Further, best practice contractual arrangements for P3s need to identify the output requirements and the key performance indicators, so that performance monitoring can be managed effectively and the risk of disputes is minimized. (Partnerships Victoria (b), pg.15)

The partners recognize and appreciate what the other brings to the P3. This recognition of each other's importance to the success of the P3 goes beyond that of purely funding and reinforces the commitment to work together towards win/win outcomes and facilitates the balancing of needs and interests among the partners. Interdependence also provides for a balancing of power, even when one partner provides the greater financial contribution or is significantly larger than the other partner. (Rodal, pg. 60)

Effective communications are essential to successful P3s, both internally and externally. Internally, clear and frequent communications among partners helps ensure all parties have a common understanding of expectations, roles, responsibilities and accountabilities that in turn builds mutual understanding and trust. (Rodal/Mulder, pg. 28) In addition, outputs need to be clearly specified from the outset and both parties need to fully understand the risks they are taking on. (Smith, pg. 13)

Externally, communication with stakeholders and clients is important to build and maintain support for the P3. Prospects for a successful P3 are best if all main stakeholders are committed to the partnership's objectives; therefore the design of the P3 should take full account of the interests of the main stakeholders. Stakeholder involvement should be maintained throughout the project. (Smith, pg. 30)
Successful P3s are flexible and able to evolve as the partnership matures or goals change. As such, arrangements among partners need to be adaptable to external pressures and future changes to policy or legislation. (Rodal, pg. 61)

Trust, respect and a non-adversarial relationship are the foundation of a successful P3. If the partners do not trust each other none of the other principles or attributes of a successful P3 are likely achievable. As Rodal explains the building of trust is a delicate and time-consuming process requiring effort by all parties to flourish. (Rodal, pg. 61)

Essential to build trust among partners and the public are transparency and integrity. (Rodal, pg. 61) P3 processes should be open and fair to all. This also applies to the public sector’s communication of the true costs associated with a project or program during its solicitation for prospective partners and in negotiating the P3 arrangement. Experience shows that as much of the contract as possible should be negotiated during the open competitive phases so the duration of exclusive negotiations is minimized. This helps insure that transparency, value for money and that the contract price is maintained (INTOSAI Supplementary guide, pg. 20).

Particularly with collaborative P3s involving shared decision making results may not be realized immediately and patience and perseverance by the partners allows relationships to build and mature. As such, managing expectations and setting realistic goals and objectives and the time frame for their achievement are important in successful P3s. (Rodal, pg. 61)
Developing a P3 project needs proper resources including involvement of specialist advisors as required. The project management team should be identified based on the skills needed for the P3 to succeed. Good legal and financial advice is particularly important.

Having staff with the right skills is critical to good contract management and to realize the full potential benefits of the partnership. A staffing and training program should be in place to ensure staff have the right skills and experience to manage the contract and build a good working relationship. Successful P3s have appropriate resources that involve senior management in place to monitor the performance of the private sector partner. (OAG-UK (d), pg. 6)

As noted in the discussion of risks, accountability for service and its quality will always remain with government even when the services are being delivered by the private sector. Therefore, successful P3s have a comprehensive and well designed accountability framework that allows for innovation and can deliver better value for money while providing for adequate control of public funds (NAO-AUS (a), pg. 35).
3.0 Jurisdictional Review of P3 Related Audit Activity

A jurisdictional review was conducted to:

- explore the extent of P3 related audit work being conducted;
- assess the applicability of these types of projects to the branch and the province; and
- use the information gathered as a resource in the development of the branch's own P3 audit tools.

Jurisdictions reviewed included the other Canadian provinces, the federal government and a number of other countries including the UK, New Zealand, Australia, and the USA. For the most part the other jurisdictions, with the exception of the UK have not done extensive audit work related to P3s to date.

Generally P3 audit activity concentrated on evaluation and assessing various aspects of well established P3s such as value for money, performance, and accountability.

As would be expected audit activity has focused on broad areas of greatest risk. Notable areas of review have included protection of the public interest; governance and accountability; value for money; transparency; innovation; managing relationships; and reporting. In general audit departments are doing little to no proactive work in the areas of P3 planning, implementation or operations and partnership management. The main exception to this was in Australia where auditors regularly provide services in the area of procurement for P3s and attesting to the probity of P3 contract solicitation and evaluation practices.
However, a number of audit departments including the BC Auditor General and federal Treasury Board are currently developing audit methodologies and frameworks for P3s. There is also substantial literature on P3s and best practices operational guides for practitioners wanting to develop P3s, which can be used to form the basis for audit-related methodologies and frameworks.

### 3.1 Canada & USA

In Canada the majority of P3 audit activity has been by the Auditor General of Canada. The provinces have undertaken very little P3 audit activity to date. A significant exception to this was a chapter in the fall 2001 report by the Provincial Auditor of Saskatchewan devoted to P3s. The report provided advice and guidance on managing accountability risks associated with P3s and was based on a review of Canadian and international literature.

The provincial auditor emphasized that government can not delegate responsibility through P3 relationships and is answerable to the Legislative Assembly for its stewardship of public money. As such, entities created by P3 agreements must be regarded as part of government and accountable to the Legislative Assembly so the lines of public accountability are not blurred. Concerns with transparency, freedom of information, and the inclusion of confidentiality clauses were also highlighted. P3 agreements should include clear provisions for allowing for change and innovation but private sector confidentiality requirements should not be allowed to override the need for government to be accountable for its use of public resources.
Focus of the Auditor General of Canada in relation to P3s has been on: governance; accountability; transparency and protection of the public interest, values and ethics; value for money; and on monitoring and reporting of results. Reports examined the Northumberland Strait Crossing project and new governance agreements in general.

The Northumberland project was a build-own-operate-transfer partnership with a private sector consortium. The focus of the audit was on planning and implementation phases of the project and project monitoring and reporting frameworks. Its purpose was to provide assurance that there was due regard for economy, the public interest was adequately protected and that financial and operational information on the project was monitored and provided to Parliament appropriately.

Specific objectives of the audit were to determine whether:

- the obligations of the government had been clearly identified in the agreements with partners;
- the procurement process was transparent and reasonable;
- there was adequate protection of the public and Crown interests;
- environmental requirements were met; and
- stewardship, financial, and operational information was monitored and reported appropriately.

The main conclusions of the Auditor General were that:
• project risk management showed improvements over other mega-projects particularly with respect to protection of the Crown against potential costs overruns;

• the procurement process was transparent and reasonable;

• the government was managing the project's environmental aspects appropriately;

• the financing arrangements were complex and a departure from usual practice, which resulted in project financing costs being approximately $45 million more than could have been obtained through traditional government borrowing;

• the government has not been appropriately reporting the liability on the balance sheet; and

• there has been little ongoing project information reported to Parliament.

Concerned that the principles of parliamentary control and accountability were at risk, in 1999 the Auditor General reviewed a number of new governance agreements, such as P3s. One result was the development of a governing framework (Figure 9) to provide guidance on the elements of that were seen as essential in collaborative arrangement such as P3s. In 2002 a follow up report examining whether the changes recommended in 1999 had been implemented and whether these governance arrangements were continuing to place accountability to Parliament at risk unnecessarily. The framework shown here as Figure 9 can be applied by internal audit when assessing new P3 governance arrangements.
Figure 9: A governing Framework for New Arrangements

To ensure credible reporting:
- Clear public objectives
- Concrete performance expectations
- Appropriate performance measurement and reporting regime

To establish effective accountability mechanisms:
- Clear roles and responsibilities
- Performance expectations that are balanced with capabilities
- Well-defined management structure
- Appropriate monitoring regime
- Partner dispute resolution mechanisms
- Specific evaluation provisions
- Procedures to deal with non-performance
- Appropriate audit regime

To ensure transparency:
- Public access to information
- Communication of information on key policies and decisions

To protect the public interest:
- Citizen complaint and redress mechanisms
- Public consultation/feedback mechanisms
- Policies to promote pertinent public sector values


Major Risk Areas

The auditor general noted that the challenges (risks) inherent in managing collaborative arrangements such as P3s are greater than for conventional programs. Because partners have their own goals, interests, authorities, administrative methods, and accountabilities creating a common vision and effective leadership is a challenge and there is a greater potential for conflict. As well partnership
arrangements are generally more complex than traditional programs or projects and co-ordination is more difficult to manage. Finally, building trust and confidence among partners takes time. (Langford/Edwards. Pg.165)

The auditor general sees both the public and private sector partners involved in collaborative arrangements and P3s has each having to meet same requirements for serving the public interest, accountability, transparency, and public reporting as the public service. To address these requirements the auditor general has prepared the following high level questions shown in Figure 10 that can also be used form the basis of possible audit objectives.

**Figure 10: Summary of OAG High Level Questions**

<table>
<thead>
<tr>
<th>Risk Area</th>
<th>High Level Questions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Serving the public interest</td>
<td>- Are government/partnership objectives being met?</td>
</tr>
<tr>
<td></td>
<td>- Is the partnership the best way to do it?</td>
</tr>
<tr>
<td></td>
<td>- Is appropriate emphasis being placed on serving the public interest?</td>
</tr>
<tr>
<td></td>
<td>- Are public service values being maintained?</td>
</tr>
<tr>
<td>Accountability</td>
<td>Are the objectives, performance standards, and results clear?</td>
</tr>
<tr>
<td></td>
<td>Are the respective partners’ roles, responsibilities and authorities clear?</td>
</tr>
<tr>
<td></td>
<td>Are expectations balanced with capacity?</td>
</tr>
<tr>
<td></td>
<td>Can performance be measured and reported effectively?</td>
</tr>
<tr>
<td></td>
<td>Is there adequate provision for review, evaluation and audit?</td>
</tr>
<tr>
<td>Transparency</td>
<td>Have the information requirements of those affected by the partnership been recognized?</td>
</tr>
<tr>
<td></td>
<td>Is appropriate and sufficient information being disclosed?</td>
</tr>
</tbody>
</table>

(Source: Edwards and Langford, pg.166)

The United States General Accounting Office had not completed audits in this area as they are still looking at P3 conceptually to see how they may work and what benefits they will bring.
3.2 United Kingdom (UK)

The UK has made extensive use of private financing to fund public infrastructure projects. In 1992 the Private Finance Initiative (PFI) was introduced to facilitate involving private sector management and expertise in the delivery of public services. More than 400 such partnership projects have been implemented in the areas of roads, rail, hospitals, schools, prisons, office buildings and IT systems. Since 1997 the UK National Audit Office (NAO) has published a number of reports on such projects examining different aspects of partnerships, and also chairs the International Organization of Supreme Audit Institutes (INTOSAI) that has developed a set of best practices guidelines for auditors. Four of the NAO audits are discussed here.

In August 1999 the NAO issued a report, which was developed from eight previous reports on PFI projects. The report’s focus is on value for money and resulted in the creation of a comprehensive analytical framework and detailed guidance questions to establish value for money in PFI arrangements.

Two primary risks to achieving value for money were identified:

- attention to process rather than to achieving a good outcome; and
- focus on reaching agreement rather than getting a good deal.

The analytical framework consists of four key pillars of examination needed to establish good value for money:

- Setting clear objectives;
• Application of the proper processes for procurement;
• Select the best deal in the market; and
• Ensuring the deal makes sense.

The framework for achievement of value for money is based on a set of hierarchical statements starting from the general and becoming more specific. Part 2 of the report provided advise to auditors in applying the framework to obtain reasonable assurance that the procuring organization has complied with each principle statement. A set of objectives, criteria and procedures based on the NAO framework is attached as appendix 5. The framework should provide guidance to auditors wanting to gain reasonable assurance that the procuring organization has achieved value for money through its partnership arrangement.

In 2000 the NAO examined the partnership between Siemens Business Services (SBS) and National Savings. In addition to assessing value for money in the procurement, the audit assessed whether the contract provided an effective framework for managing the relationship. Undertaken during the first year of the partnership, the NAO found that performance to date had been encouraging, the contract successfully aligned the interests of both parties, and mechanisms were in place to effectively manage the contract. The audit broadened the scope of the kind of projects that had P3 potential, and also demonstrated how these arrangements can be a way of modernizing government, transferring risk, increasing innovation, and improving efficiency.

In 2001 further work in the area was undertaken resulting in a report entitled "Managing the relationship to secure successful partnerships in PFI projects". The review examined project
implementation and management to determine whether the public sector managed its relationships to secure a successful partnership. A successful partnership was defined as one that allows the participants to work together to achieve their objective to their mutual benefit: the public sector receives a service that represents value for money; and the contractor delivers that service for a reasonable return. This review was completed by survey the results of which were used to develop further best practices for the management of P3/PFI projects highlighted in Figure 11.

Figure 11: NAO Partnership Relationship Framework

<table>
<thead>
<tr>
<th>Success Factors</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Roles and responsibilities must be clearly understood.</td>
<td>A good partnership relationship is one where both sides are open, share information fully and work together to solve problems. Clearly understood roles and responsibilities help to minimize conflict, confusion and potential disputes. The governance framework should include arrangements for discussing performance and service improvement, change, business and strategic development, and the resolution of disputes. The arrangements for monitoring the long-term contract and any changes are crucial if a partnership is to continue to deliver the services required.</td>
</tr>
<tr>
<td>There must be open communication.</td>
<td>Maintaining open communications is key to ensuring that both parties continue to work in an effective manner. Communications are enhanced when there is an open and trustworthy environment.</td>
</tr>
<tr>
<td>Authorities need to create scope for innovation.</td>
<td>Innovation is a key factor, which can contribute to better value for money in partnerships and is supported by a commitment to continuous improvement by all parties.</td>
</tr>
<tr>
<td>A practical approach to the relationship is needed.</td>
<td>Measurement and reporting on performance is important, however monitoring of partner performance should not be oppressive. Practical interpretation of contract aids building the relationship. Discussing and documenting how contractual terms will be interpreted before the contract is signed can help minimize differences later.</td>
</tr>
<tr>
<td>Regular review and monitoring of the partnership relationship is needed.</td>
<td>All business relationships can benefits from regular review to consider ways the relationship can be improved. This would include monitoring the appropriateness of contractual incentives and performance indicators to ensure they do not unintentionally provide incentives for undesirable outcomes.</td>
</tr>
</tbody>
</table>

(Source: NAO, Managing the Relationship to Secure a Successful Partnership on PFI Projects, 2001, pg. 23-37)
A Public Sector Comparator (PSC) is a benchmark against which value for money of a P3 can be assessed. The PSC is a cost estimate of the hypothetical risk-adjusted cost of a project if it were to be financed, owned, implemented and operated by government. (Partnerships Victoria (c), pg. 6) In other words, the PSC is based on the assumption that the ministry will acquire the assets through conventional procurement means and retain significant managerial responsibility and exposure to risk. (OAG-UK (a), pg. 18)

In 2000 the NAO completed an audit of the financial analysis performed as part of the London Underground Partnership. The audit took a proactive approach and was conducted prior to the award of the contract. The NAO used an issue analysis approach by setting four high-level questions as primary criteria to be answered in order to assess the objective of assessing the PSCs and their use. The high-level questions used included whether the:

- relevant guidelines had been followed;
- PSCs were sound;
- evaluation of bidder's prices was being conducted soundly; and
- comparison between the bid prices and the PSCs were likely to be sound.

A significant finding of the audit was that financial analysis alone cannot be expected to show clearly which public or private sector option, for managing and funding a project, would provide better value for money. Financial analysis can provide useful but incomplete information into the real value for money of alternative P3 approaches because it does not, and cannot take into account all the factors that are relevant to assessing the relative value for money of alternative approaches. (OAG - UK (b), pg. 2)
Two other important lessons were learned from the audit. First, the process of preparing a PSC should not be separated from the rest of the P3 procurement process. Close co-ordination between ministry staff, technical advisors and financial and modeling experts help ensure that value for money decisions are not based on one-dimensional comparisons of single PSCs. Secondly, the success of a P3 requires a real alignment of interests between contracting parties to ensure that the partnership is more than just a statement of intent and to achieve such an alignment all partners and stakeholders need to be engaged throughout the process. (OAG - UK, pg. 2)

3.3 Australia & New Zealand

The Australian National Audit Office (ANAO) completed an audit of Joint Commercial Arrangements in 1996. The objectives of the project were to assess whether: significant risks were appropriately addressed; value-for-money was achieved; the public interest was protected; and resources and facilities were effectively managed. As a result of the audit a guideline for achieving value for money in P3 agreements was created as a tool for government negotiating new projects. The guideline covers the phases of a P3 including: needs analysis; preliminary planning; final planning and establishment; implementation; project completion and evaluation; and ongoing arrangements. (NAO - AUS (c), pg. 6-10) Although presented as a tool for managers the guideline can be easily re-framed as audit criteria for evaluating P3 projects.

In a speech delivered to the Board of Audit from Tokyo and Japan in October 2001 the auditor general expressed a concern that an over-emphasis on accountability could prohibit appropriate risk management and innovation. As a result, he stressed that when
examining collaborative arrangements such as P3s for proper accountability it must not be approached in such a rigid way as to result in missed opportunities to deliver better value for money. The auditor general saw auditors responding to this new P3 collaborative environment by supporting and encouraging worthwhile change, while providing independent scrutiny and assurance. This would include such things as:

- taking an open mined and supportive approach to innovation, appropriate risk-taking and experimentation including examining how the innovation has worked in practice and the extent to which value for money has been achieved; and

- providing independent advice and encouragement to management implementing P3s by drawing on their P3 audit experiences and identifying and promoting good practices so that experience can be shared and risks minimized. (NAO-AUS (a), pg. 35)

In addition the auditor general saw a role for auditors in helping to ensure good governance frameworks for P3s. Good governance arrangements increase participation; strengthen accountability mechanisms; and open channels of communication within, and across organizations. The greater involvement of the private sector in delivering public services through P3s adds increased complications to creating and maintaining common understandings, cultures, values and ideas of accountability and responsibility. This will mean that in addition to traditional assessment activities auditors will have to be more pro-active in helping to develop governance frameworks without undermining their independence. (NOA-AUS (a), pg. 42)
In a second speech in June of 2002, "Auditing in a Changing Government Environment", the auditor general focused on issues emerging with public reporting of P3 information. Commercial-in-confidence clauses often included in P3 arrangements can result in a loss of access to information needed for reporting to elected officials and the public. This can adversely impact accountability, openness and transparency of the process, and the public interest. The ANAO found that value for money results for P3s can be particularly difficult to demonstrate when business, commercial or financial information is not available in the public domain. (NOA-AUS (b), pg. 6-8)

Therefore the risks with commercial-in-confidence clauses in P3 agreements need to be identified and addressed to ensure public interests can be protected and government can have access to the information needed to complete audits. One way to achieve this is by proactive involvement by auditors in the planning and implementation phases of P3s. Through such involvement the auditor can assist management in identifying these risks and ensuring that appropriate controls are in place. This could include ensuring prospective private sector partners are aware of the public accountability requirements or contract clauses ensuring access to information and the right to audit are included.

Partnerships Victoria is a policy of the Australian Government that provides a high level framework for creating partnerships between government and the private sector. In addition to the policy there is detailed guidance materials to those managing P3s. Value for money and the public interest are aspects of the policy. Included in the guidance to managers is a requirement that "probity practices
ensure that the purpose is achieved with fairness of process and with no person improperly achieving personal advantage or disadvantage through involvement in the process." (Partnerships Victoria (b), pg. 95)

P3 projects under the policy are of sufficient size and complexity to warrant the appointment of an independent probity auditor to address the risk that potential bidders may perceive the procurement process as unfair or biased. The function of the auditor therefore, is to attest that the project probity plan is sufficient to ensure that processes will be fair and equitable, that the project's probity plan was followed, and that all processes have been conducted fairly and equitably.

Prior to requesting expressions of interest from the private sector the auditor reviews and approves management's probity plan. Then during the procurement process the auditor acts as an independent observer of process including any in dealings between bidders and the procurement team and the evaluation of bids or proposals. The auditor also provides ongoing advice to the procurement team and management. Finally, before a recommendation to sign an agreement or contract is made the auditor issues an audit report attesting to the fairness and equity of the procurement process.

Audit activities related to P3s are currently just evolving in NZ. At Audit NZ they are only just beginning to think about the sorts of issues and methodologies that will need to be developed to both audit and review P3 projects.
3.4 International Organization of Supreme Audit Institutes

Founded in 1953 the International Organization of Supreme Audit Institutes (INTOSAI) is the professional organization of supreme audit institutions (e.g., Auditor General of Canada) in countries that belong to the United Nations or its specialized agencies. INTOSAI supports its members by providing opportunities to share information and experiences about the auditing and evaluation challenges facing them in today's changing and increasingly interdependent world. As a leader in public sector auditing, INTOSAI issues international guidelines for financial management and other areas, develops related methodologies, provides training, and promotes the exchange of information among members. INTOSAI works in five languages: Arabic, English, French, German and Spanish.

In 1993 the INTOSAI established a working group on the Audit of Privatization who in October 2001 completed guidelines for the audit of public/private finance concessions (i.e., P3s). The purpose of the guidelines are to provide a logical framework for public sector audit organizations wishing to audit these agreements to establish whether the public has received value for money. There are a total of forty-seven guidelines complete with supplementary guides grouped into five parts: the general audit approach; defining scope; project management; the contract; and value for money evaluation. Although these guidelines were produced for external auditors to government such as the Auditor General they can also be adapted to provide guidance to internal audit departments. A full copy of the guidelines may be viewed by accessing the INTOSAI's website at www.intosai.org. Parts of the guidelines have also been adapted for internal audit use and are included in this report in appendix 6.
4.0 Role of Internal Audit & Advisory Services

It is likely public sector financial resources will continue to be limited and that management will look for alternative, better ways such as P3s to deliver public infrastructure and services. P3s already represent a significant and growing aspect of a number of ministry service plans. Most P3s are also financially substantial in size, involve complex arrangements, and have a number of unique attributes and risks that distinguish them from traditional government programs or organizations.

As a result, ministry management will need and demand high quality value added P3 related services. As the Province's internal auditor, Internal Audit & Advisory Services (IAAS) is in a unique position to provide a variety of value added P3 related services to client ministries. Providing such services also aligns well with IAAS's mission, goals and objectives.

The IAAS's mission is to: "To work co-operatively with public sector management and staff to improve the efficiency, effectiveness, economy and accountability of public sector programs, operations, agencies and institutions." To achieve its mission the IAAS undertakes a broad range of client-focused, timely, relevant, value-added, and cost-effective audit and consulting services. P3 related services clearly fit within this mission and would also directly contribute to two of the branch's goals and three related strategic objectives shown in Figure 12.
### Figure 12: Related IAAS Goals and Objectives

<table>
<thead>
<tr>
<th>Goal</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Goal 1</td>
<td>To provide advice to management to improve and strengthen public sector programs.</td>
</tr>
<tr>
<td>Goal 2</td>
<td>To provide innovative products and services to exceed our clients’ expectations.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Objective</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Objective 1</td>
<td>Work in areas of highest risk and value.</td>
</tr>
<tr>
<td>Objective 2</td>
<td>Provide senior management with independent assurance that their systems of internal control support achievement of established public sector goals and objectives.</td>
</tr>
<tr>
<td>Objective 3</td>
<td>Improve the economy, efficiency and effectiveness of public sector operations.</td>
</tr>
</tbody>
</table>

Therefore, to meet client's needs and attain high levels of client satisfaction, the branch should be prepared to offer P3 related services to client ministries. However, before suggesting the types of P3 related services that the IAAS is, or is not best suited to provide, some discussion of the roles already assumed by other BC service providers is necessary.

### 4.1 Other Suppliers of P3 Related Services

There are a number of public and private organizations in BC that currently offer P3 related services. Some of these organizations have assumed roles that would compete directly with the IAAS while others have more complementary roles. In order for IAAS to assess how best it can best serve its clients and integrate its future role with these other organizations some background information on these organizations is presented here. The organizations discussed include: Partnerships BC; the Office of the Auditor General of BC; Ministry Partnership Departments; and private sector accounting, consulting and legal firms.
**Partnerships British Columbia**

Partnerships BC is a newly formed company formed to bring together ministries, agencies and the private sector to create innovative solutions for meeting the Province's infrastructure needs. Partnerships BC reports, through its Board of Directors, to its only shareholder, the Minister of Finance. The organization is responsible for identifying, assessing, prioritizing and implementing P3 projects that are economically viable and in the Province's best interests. It advises and assists government and public sector agencies to:

- identify opportunities for P3s and other types of alternative service delivery (ASD);
- identify opportunities to maximize the value of capital assets, through such means as asset leveraging;
- prepare business cases and strategic options analyses for potential P3 and ASD projects;
- prepare solicitation documents, such as Expressions of Interest and Requests for Proposals;
- manage P3 procurement and asset-related processes; and
- negotiate contract terms with private sector partners and service providers.

Partnerships BC also provides a central repository of P3 knowledge and know-how, offering:

- ongoing opportunities to expand B.C.'s knowledge base around P3s and ASD;
• insight into the full spectrum of P3/ASD projects in Canada and around the world;

• technical understanding of deal structuring and P3 assessment techniques, including risk analysis, value for money and public interest considerations;

• practical expertise in both provincial infrastructure procurement and negotiating/implementing P3 projects in other jurisdictions; and

• single-window access to government for potential private sector partners.

Finally, Partnerships BC sees itself as being the government's lead P3/ASD educator through activities such as:

• leading the province's P3 policy development;

• conducting and participating in educational seminars and conferences for both the public and private sectors; and

• preparing standard templates and documents for use on P3/ASD projects.

Partnerships BC is planning to have its own internal audit department. The expected role of the department is not yet known and it is unclear whether Partnerships BC envisions its internal audit department having a role in auditing P3s. As a crown corporation Partnerships BC is not required to use IAAS as its internal auditors. Discussing the respective roles of IAAS and Partnerships BC’s internal audit department was outside the scope of this project.
Recommendation

(1) Internal Audit & Advisory Services should discuss with Partnerships BC the planned role for its internal audit department and how IAAS could provide assistance.

Ministry Partnership Departments

Ministries of Transportation (MOT) and Sustainable Resource Management (MSRM) both have internal departments specializing in P3s and ASD. As ministries, MSRM and MOT are required to use IAAS as their internal auditors. Therefore, to provide value added internal audit services to our clients it is important that the IAAS establish and maintain a relationship with ministry departments involved in partnership activities. The following provides a briefly introduction to the partnership activities of MSRM and MOT as at fall 2002.

The Partnership Branch, Integration and Partnership Office, Business and Information Services Division of MSRM is responsible for leading the ministry's pursuit of partnerships that will yield net annual savings of $40 million through cost recovery, cost reduction and cost avoidance. The branch has issued a Partnership Management Framework to guide ministry managers and staff pursuing partnership opportunities. The framework is divided into two parts:

Part1 - Partnership Strategy and Policies, to set direction, define expectations, and illustrate concepts and practices.

Part 2 - Procedures and Administrative Tools, to provide practical guidance, promote consistent practices, and as a source of further information.
The framework also has three underlying principles:

1. To align ministry and government priorities.

2. To reduce the costs of core service delivery.

3. To streamline ministry business processes.

For detailed review the framework can be found on the ministry's website. [http://srmgww.bcgov/bisd/partnership.html] MSRM partnership policy requires that programs, costs and benefits, performance and delivery, and partnership agreements be subject to audit.

Within the Ministry of Transportation the Partnerships Department has responsibility for facilitating the installation of transportation infrastructure in a cost-effective manner and without recourse to tax revenues. The Partnership Department will develop design-build-develop and design-build-own-operate-transfer and other types of P3s. There are three branches in the department responsible for the:

- development of policy and strategies to aid in the implementation of the department's mandate;

- development of projects to be wholly or partially financed through inclusion of ministry land adjacent to projects whose value will be increased by the project; and

- management or sale of other ministry land to produce revenues to finance other highway improvements.
The project teams within the department will be focused on developing potential P3s for new highways or major highway upgrades and delivery of the P3 projects. The department will be working closely with Partnerships BC to ensure the P3s result in value for money and protection of the public interest.

In June 2002 the ministry issued a draft policy paper entitled Creating Opportunities for Expanding Transportation Infrastructure for public review and comment. The ministry is "committed to working with the private sector, to explore and develop new cost-effective methods for expanding infrastructure through P3s." To provide a clear, accountable framework for transportation related P3s the ministry has introduced enabling legislation in the form of the Transportation Investment Act. The policy paper and the Act can be found on the ministry’s web site and should be reviewed by internal audit staff when planning any P3 audit projects for the ministry.

(http://www.th.gov.bs.ca/BCHighways/partnerships/Alternative_Delivery.html)

**Recommendation**

(2) Internal Audit & Advisory Services should establish and maintain co-operative relationships to exchange information with ministry departments involved in partnership activities.

**Auditor General of British Columbia**

At the time of this report the Office of the Auditor General (OAG) was in the process of defining their position on the government's P3 initiative. The OAG has recognized the need for heightened public accountability and performance of P3s. As such, the OAG's role will likely be to assess whether prudent procedures are being followed to manage the risks associated with P3s.
To this end they have committed to developing appropriate audit methodology to assess P3 management practices and have already stated their intention to review the Capital Asset Management Framework. In addition a project to assess the Ministry of Transportation's processes to ensure that the risks associated with any P3s will be adequately identified and properly managed is included in their 2002/03-2004/05 Service Plan.

Due to the significant size and complexity associated with many P3 arrangements it is highly likely that the OAG will be interested in conducting performance audits on P3s and reporting results to the Legislature and public. Based on the type of audit activities already done by other auditor generals it is likely the focus of the OAG's activity will be on protection of the public interest and value for money. It is also likely that the OAG will be more interested in examining issues significant to the public over a number of P3s rather than individual P3s or issues significant to management.

However, in order to avoid potential duplication of P3 audit activity between the OAG and IAAS planned audit activity will need to be co-ordinated.

**Recommendation**

(3) Internal Audit & Advisory Services should communicate with the Auditor General of BC to co-ordinate P3 related audit activity to avoid duplication.

**Private Sector Organizations**

There are a number of private sector legal, accounting and consulting firms that offer P3 related advisory services to both the private and public sectors. Many of these firms are large and able to draw on experience and expertise both within and outside BC. Many of these firms and consultants have extensive experience in P3s.
For example large law firms such as Fasken Martineau or Goodmans specialize in P3s and have extensive experience in providing a full range of legal services in connection with P3s. Some of the P3 related services such law firms provide include advising on:

- the structuring of tender and bid procedures;
- maximizing proceeds to government while protecting the public interest;
- structuring of finance transactions;
- contractual matters; and
- assessments of risks and risk allocation and transfer.

In addition, the large accounting firms such as PricewaterhouseCoopers (PwC) have specialized groups with experience advising on P3s. PwC for example offers services ranging from advising on strategy formulation through transaction implementation of infrastructure and services sectors such as energy, water, transportation and healthcare. Some of the projects they have been involved with in BC include the Abbotsford Health Care Facilities, the Richmond-Airport Vancouver Rapid Transit project, the Kamloops Water Treatment Plant, and BC Online. There are also a number of specialized consulting firms offering their services to aid private and public sector partners in developing P3s. One such firm is Klohn Crippen who offer P3 related advisory services related to transportation infrastructure projects such as coordinated project management.
4.2 Types of P3 Related Services ill Suited to IAAS

There is little opportunity for IAAS to provide specialized consulting and advisory services to ministries planning and implementing P3s. Others such as Partnerships BC, internal ministry departments like the Partnership Branch in the Ministry of Sustainable Resource Management, and private sector law, accounting and consulting firms are already well positioned and available to ministries.

IAAS currently does not have comparable resources, expertise or experience that would enable it to compete with these organizations in providing specialized P3 consulting and advisory services such as legal, engineering or project financing advice. IAAS is relatively small in size and has a generalist rather than specialist structure.

Therefore, significant time and resources would be required to build IAAS capacity to a level able to provide comparable specialist advisory services to ministries. It would also be unlikely that IAAS could ever match the level of resources, expertise and experience of these public and private sector organizations.

However, IAAS can offer and provide consulting and advisory services related to its core services and for which it already the capacity and expertise. IAAS is well positioned to continue to provide advisory services related to such areas as governance, accountability, performance measures, accounting and auditing based on staff core competencies and knowledge of the public sector. These services would be of value to ministry management of both public sector programs and P3s.

Finally, providing some specialized consulting and advisory services to ministries such as preparing business cases for ministries would make it difficult for the IAAS to maintain its independence in order to provide assurance services.
Recommendation

(4) Internal Audit & Advisory Services should continue to provide core consulting and advisory services but not commit resources to building its capacity to offer additional specialized P3 consulting and advisory services to ministries.

4.3 Types of P3 Related Services Best Suited to IAAS

Having established that P3 related consulting and advisory services are not well suited for provision by IAAS a discussion of those services that are best suited is in order. Internal Audit & Advisory Services is best suited to offer client ministries a range of traditional audit services related to P3s and should continue to develop its capacity to provide these types of services. Whenever possible a proactive forward-looking approach should be adopted.

Based on existing skill sets within IAAS and the range of activities encompassed by P3s the opportunity exists for the IAAS to add value for ministry clients by providing various audit related services in all stages of P3s. As has been discussed, much of what makes for successful P3s is not new. Many of the principles and risks associated with P3s are simply variations on traditional principles and risks. As a result, traditional audit experience, skills and knowledge can be applied to P3s.

This positions IAAS well to offer client ministries a range of traditional audit services related to P3s. Such services would include, but would not necessarily be limited to:

- Assurance Services;
- Risk and Controls Reviews;
- Performance Auditing;
- Due Diligence Reviews;
- Attestation Services; and
- Compliance and Financial Auditing.

Depending on the particular requirements of the ministry partner or identified risk areas IAAS should be in a position to perform both broad and narrow scope audits of P3s. While this proposed role for IAAS might be more traditional in nature, being internal to government provides IAAS with the opportunity to be more proactive in its involvement and projects than would be the case for external auditors. A proactive approach is forward looking rather than critical and is designed to assist ministries in improving operations to achieve objectives.

Although internal audit reports are generally assessable to the public through freedom of information they are not automatically reported to the public and the legislator as for audits done by the Auditor General. This provides an opportunity for the IAAS to provide audit services and reports specially designed and written to provide assurance and suggestions to improve P3 arrangements for ministry management. Such an approach would likely be seen as adding substantial value by clients as it is more coaching rather than critical in nature.

Although audit services provided by IAAS will be similar in nature to those provided by the Auditor General, a proactive approach by IAAS would differentiate its services from those of the Auditor General. IAAS can also assist management in ensuring they are prepared for external audits by the Auditor General, thereby avoiding a public airing of shortcomings.
Recommendations

(5) Internal Audit & Advisory Services should continue to develop its capacity to provide traditional internal audit services related to P3s.

(6) When ever possible Internal Audit & Advisory Services should take a proactive forward-looking approach to its provision of P3 related audit services.

4.5 Level of Internal Audit Activity Based on Life Cycle Phase

Having established in a general context, the types of P3 related internal audit activity that IAAS is best suited to provide it is also important to examine when it would be the most beneficial to provide services. IAAS can provide internal audit services throughout the life cycle of a P3, however the value added by the services will be of more value to client ministries during some phases than others. In order to assess the potential value of internal audit services at any given point in a P3 life cycle a high level assessment of the risks associated with each phase is required. The common risks associated with P3s and each phase in their life cycle was discussed in section 2.4.

Based on the risks commonly associated with each phase and the types of audit services IAAS could provide a matrix can be created showing the potential value added by IAAS services for each phase and risk area. To provide an initial focus for audit activity the three main risk areas were used to assess value added potential, they are; protection of the public interest; governance and accountability; and value for money. Figure 13 illustrates the level of potential value added through internal audit services by general risk area for each of the five main life cycle phases of a P3 and the nine high level steps.
## Figure 13: Level of Potential Value Added by Internal Audit Involvement

<table>
<thead>
<tr>
<th>Life-Cycle Stage</th>
<th>High Level Step</th>
<th>Level of Potential Value Added by Internal Audit Involvement</th>
<th>Type of Internal Audit Activity</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>General Risk Area</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Public Interest, Governance, Accountability and Performance Measurement, Value for Money</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(see legend below)</td>
</tr>
<tr>
<td>Pre-planning and Decision</td>
<td>Strategic Analysis and Identification of Needs</td>
<td>L</td>
<td>L</td>
</tr>
<tr>
<td>Analysis of Opportunities</td>
<td>M</td>
<td>L</td>
<td>M</td>
</tr>
<tr>
<td>Planning, Development and Approval</td>
<td>Business Case Analysis</td>
<td>H</td>
<td>L</td>
</tr>
<tr>
<td>Identification and Selection of Partners</td>
<td>H</td>
<td>M</td>
<td>H</td>
</tr>
<tr>
<td>Project Development &amp; Implementation</td>
<td>Final contract negotiations with selected partner Implementation</td>
<td>H</td>
<td>H</td>
</tr>
<tr>
<td>Operations &amp; Partnership Management</td>
<td>Ongoing partnership management, performance monitoring and evaluation</td>
<td>H</td>
<td>H</td>
</tr>
<tr>
<td>Learning, modification and improvement</td>
<td>H</td>
<td>H</td>
<td>H</td>
</tr>
<tr>
<td>Wind-up - Renewal</td>
<td>Completion and Continuation</td>
<td>H</td>
<td>L</td>
</tr>
</tbody>
</table>

### Internal Audit Activity Legend

<table>
<thead>
<tr>
<th>Activity Code</th>
<th>Type of Internal Audit Activity</th>
<th>Activity Code</th>
<th>Type of Internal Audit Activity</th>
</tr>
</thead>
<tbody>
<tr>
<td>AS</td>
<td>Assurance Services</td>
<td>RC</td>
<td>Risk and Controls Reviews</td>
</tr>
<tr>
<td>PA</td>
<td>Performance Audits and Reviews</td>
<td>DD</td>
<td>Due Diligence Reviews</td>
</tr>
<tr>
<td>AT</td>
<td>Attestation Services such as Probit Audits</td>
<td>CFA</td>
<td>Compliance and Financial Audits</td>
</tr>
<tr>
<td>CAS</td>
<td>Consulting &amp; Advisory Services</td>
<td>OR</td>
<td>Operational Reviews</td>
</tr>
</tbody>
</table>
In the Pre-planning and Decision phase which includes the strategic analysis and identification of needs and analysis of opportunities steps the potential for value added from the types of traditional audit services provided by IAAS is assessed as low to medium for all three risk areas. It is during this stage that expert consulting and advisory services would likely provide the greatest benefits to ministries.

During the Planning, Development and Approval phase which includes the business case analysis and identification and selection of partners steps the potential for value added is assessed as high for protection of the public interest and value for money and low to medium for governance and accountability. This is because the business case analysis and identification and selection of partner steps are critical to the ministry establishing value and ensuring protection of the public interest later in the life of the P3.

Therefore, proactive involvement of internal audit during these steps can potentially add significant value. The risks associated with governance and accountability are not yet high as governance and accountability frameworks have likely not yet been designed. Some examples of the types of internal audit services that IAAS could provide during this life cycle phase could include:

- Due diligence reviews of ministry business cases and the public service comparators to provide assurance to management that sufficient analysis was done by the ministry or its advisors and the comparators used to demonstrate value for money are reliable and comprehensive.
• Attesting to the fairness and value for money provided through the contract solicitation, evaluation and award process to providing bidders and the ministry with assurance that the procurement process is fair and appropriate.

During the Project Development & Implementation phase which includes the final contract negotiations with the selected partner and implementation steps the potential for value added is assessed as high for all three areas. Proactive involvement of internal audit during this phase has the potential to yield the greatest benefits to ministries as the suggestions for improvements identified during audit work can be more easily implemented prior to the signing of contracts or during implementation rather than after systems and processes have already been established. Some examples of the types of internal audit services that IAAS could provide during this life cycle phase could include:

• Assessing contracts prior to signing to provide assurance that operational risks have been appropriately allocated, appropriate financial and operational controls, reporting and audit access requirements are included.

• Governance, accountability and performance measurement reviews during implementation of P3s to ensure appropriate governance and accountability frameworks are being put in place to provide value for money and protection of the public interest during the operation of the P3.

• Proactive risk and controls reviews to ensure that all the significant risks are identified and processes are planned to manage them.
During the Operations & Partnership Management phase, which includes the ongoing partnership management, performance monitoring; and evaluation and learning, modification steps, the potential for value added is assessed as high for all three areas. Involvement of internal audit during this phase is consistent with the more traditional timing of audit activities. Some examples of the types of internal audit services that IAAS could provide during this life cycle phase could include:

- Audits of partner activities to assess compliance with the terms and conditions of the P3 agreement.
- Risk and controls reviews of the operations of the P3 to ensure that all the significant risks are identified and managed.
- Periodic financial audits to assess compliance with public sector financial controls and ensure accountability for how public sector funds are used.
- Periodic performance audits to assess the effectiveness of the P3 in achieving its objectives while maintaining value for money and protection of the public interest.

During the Wind-up - Renewal phase, which includes the completion and continuation step, the potential for value added is assessed as high for protection of the public interest and low to medium for the other two risk areas. This is because there are likely significant public interest risks to be managed during the wind up of a P3. An example of the type of internal audit service that IAAS could provide during this life cycle phase might be to review wind-up processes to provide assurance to management that the significant risks to protection of the public interest are identified and managed during shut down.
Recommendation

(7) Internal Audit & Advisory Services should focus its P3 related internal audit activities to those areas providing the highest potential value added to clients as set out in Figure 13.

4.5 Audit Services Based on Risk Assessment

The final consideration in assessing the level of P3 related audit services that IAAS should provide is overall risk. Consistent with current practices the level of IAAS involvement with P3s should be based on an assessment of risk. Using the branch's exiting risk assessment methodology that combines subjective and objective criteria, the branch should identify and work in areas that management and the branch agree represent the highest audit risk and greatest payback.

Integration with EWRM

Over the next two years ministries will be implementing Enterprise-wide Risk Management and integrating it into their service plans. Because IAAS plans to use ministries’ EWRM plans in planning audit activities it is important that P3s be included. Depending on the accounting treatment and life cycle stage of each P3 they many not be readily identifiable through reviews of ministry financial statements, budget allocations or service plans and therefore, may not be included in ministry EWRM plans. By working with client ministries to ensure any P3s are included in their EWRM plans and therefore, in internal audit's risk assessments IAAS can continue to work in areas of greatest risk and potential benefit whether they are delivered directly by the public sector or through alternate service delivery.

Recommendation

(8) Internal Audit & Advisory Services should work with ministries to ensure that all significant P3s are included in their Enterprise-wide Risk Management plans.
5.0 Internal Audit P3 Practice Aids

This section and related appendices provide some preliminary guidance, frameworks, objectives and criteria for management and staff of IAAS to use in planning various P3 related audit and review projects. The information provided is not meant to be all-inclusive, and will likely require selective application and editing, but is meant to provide a base for internal auditors to use when planning P3 audits and reviews. As IAAS staff gain experience in applying these frameworks to P3s they can be refined and expanded. As IAAS undertakes other types of P3 audits and reviews the frameworks used can be added.

Much of the guidance, manuals, checklists, and best practices used by management and P3 practitioners can be used as the basis for audit and review frameworks. The following organizations and websites are good sources of information for auditors planning P3 related audit projects. Each site contains guidance and reports as well as links to other related sites.

- Partnerships BC at (www.partnershipsbc.ca).
- The Public-Private Partnership (P3) Office at (www.strategis.ic.gc.ca/SSG/ce01373e.html).
- Partnerships UK at (www.partnershipsuk.org.uk).
- Canadian Council on Public Private Partnerships at (www.pppcouncil.ca).
- Public Private Partnerships Programme (4Ps) at (www.4ps.co.uk).
Accountability and Performance Measurement

The IAAS Model for Effective Performance Management and Accountability can be adapted and used as a basis for assessing P3 accountability frameworks. In addition, other effectiveness and performance frameworks such as the CCAF Twelve Attributes of Effectiveness, the CICA's CoCo framework, or the COSO Internal Control - Integrated Framework can be adapted and used as a basis for assessing the performance and accountability of P3s. The models are not reproduced here but can be accessed through the Ministry of Finance's website.

(http://www.fin.gov.bc.ca/ocg/ias/Accountability_Model.htm)

Procurement Attestation

Selection of a partner involves planning the selection process, soliciting proposals, evaluating proposals, and selecting the successful proponent. P3s often involve large amounts of money and long-term relationships. The costs to the bidders or preparing proposals for P3s are significant. Therefore, the consequences of the partner selection process being perceived by the potential bidders as biased or unfair can be serious. Private sector operators have stated that a fair and timely procurement process was a critical criterion to their participation in P3s. One way of providing potential bidders with assurance that the procurement process is fair and appropriate is by having an independent auditor attest to its fairness. Partnerships Victoria in Australia calls this a Probity Audit. A template audit program for such an audit is attached as appendix 4 (page 107).
Compliance Audits

Although auditing for compliance may be undertaken, this guide does not provide the specific steps necessary to perform a formal compliance audit.

Should a compliance audit be undertaken, provincial P3 or ASD policy guidance should be used as a reference in developing audit programs.

Value for Money Audits

Appendix 5 (page 110) presents the NAO framework for assessing value for money in a private sector financing partnership procurement. The framework provides guidance on objectives, criteria and procedures an auditor should address in order to gain reasonable assurance that the procuring organization has achieved value for money through its partnership arrangement.

Appendix 6 (page 114) contains a framework complied from the guidance developed by the International Organisation of Supreme Audit Institutes for auditing private finance concessions and the analytical framework for examining value for money of P3 agreements developed by the UK National Audit Office.

Possible Audit Objectives and Criteria by Life Cycle Step

Appendix 7 (page 122) contains a number of possible internal audit objectives and related criteria for examining the efficiency and effectiveness of management processes at various stages in a P3 life cycle. The information presented was developed by KPMG for the Canadian Federal Government and has been adapted for IAAS and for P3s.
Bibliography


Canadian Institute of Chartered Accountants, "Guidance on Control." Control and Governance, Number 1, November, 1995.


a) "Examining the value for money of deals under the Private Finance Initiative." August 1999.


Edwards, M., Langford, J., "New Players, Partners and Processes: A Public Sector Without Boundaries?", National Institute for Governance, University of Canberra, Australia, Centre for Public Sector Studies, School of Public Administration, University of Victoria, Canada, 2002.


KPMG:

a) "Draft ASD Internal Audit Guide." 2002

b) "Draft ASD Management Guide." 2002


a) Speech delivered by the Auditor General to the Senior Staff of the Board of Audit from Tokyo and Japan, October 18, 2001.


b) "Involving Others in Governing - Accountability at Risk." 1999.


Partnerships Victoria, Australia (http://www.partnerships.victoria.au):


Provincial Auditor of Saskatchewan. "Managing accountability risks in public-private partnerships." Saskatchewan, Canada, Fall Report Volume 2, Chapter 4, 2001 (http://www.auditor.sk.ca)


Trottier, M., Maguire, J. "Case Studies." Saskatchewan Institute of Public Policy, Public Policy Paper #4, 1999
# Appendix 1 - Summary of UK partnership models

<table>
<thead>
<tr>
<th>Category</th>
<th>Definition</th>
<th>Opportunity</th>
<th>Challenge</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Asset Sales</strong></td>
<td>The sale of surplus public sector assets</td>
<td>To release the potential of public sector assets by exploiting private sector finance and management, and other private sector skills and capabilities.</td>
<td>To safeguard any continuing public sector interest in such assets, and ensure the taxpayer receives value for money, both at the time of the sale and by sharing in any future growth in the value of the asset.</td>
</tr>
<tr>
<td><strong>Wider Markets</strong></td>
<td>Introducing the skills and finance of the private sector to help make better use of assets (both physical and intellectual) in the public sector.</td>
<td>To exploit the potential of public sector assets (both physical and intellectual) which cannot easily be sold, and to share in the returns.</td>
<td>To identify assets where such potential exists, and to ensure that the taxpayer receives a fair share of the returns.</td>
</tr>
<tr>
<td><strong>Sales of Businesses</strong></td>
<td>The sale of shares in state-owned businesses, by flotation or trade sale, with the sale of a minority or majority stake.</td>
<td>To lever-in private sector investment, capital market disciplines and therefore improved management performance, to release the potential of state-owned businesses.</td>
<td>To ensure the benefits of the P3 are shared fairly with employees, customers and the taxpayer.</td>
</tr>
<tr>
<td><strong>Partnership Companies</strong></td>
<td>Introducing private sector ownership into state-owned businesses, while preserving the public interest and public policy objectives through legislation, regulation, partnership agreements or by government retention of a special share.</td>
<td>To bring in the benefits of private sector ownership, including private sector investment, while safeguarding the continuing public interest in the business.</td>
<td>Same as for sales of businesses above.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>In addition, the government will ensure that arrangements to safeguard the public interest are targeted, so as not to restrict unnecessarily the scope for private sector management to add value.</td>
</tr>
<tr>
<td><strong>Private Finance</strong></td>
<td>The public sector contracts to purchase quality services, with defined outputs, on a long-term basis from the private sector, and including maintaining or constructing the necessary infrastructure.</td>
<td>To benefit from private sector innovation, to generate radical new synergies between the design and operation of assets, and take advantage of private sector commercial discipline, to modernize public services and obtain better value.</td>
<td>To define clearly the requirements on the private sector partner from the start, and to ensure there is a proper and appropriate allocation of risks between the public and private sectors, so as to deliver real improvements in the quality of service provided, and value for money for the taxpayer.</td>
</tr>
</tbody>
</table>

*Adding Value: An audit reference manual on Public-Private Partnerships* • 93
<table>
<thead>
<tr>
<th>Category</th>
<th>Definition</th>
<th>Opportunity</th>
<th>Challenge</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Joint Ventures</strong></td>
<td>Partnerships in which public and private sector partners pool their assets, finance and expertise under joint management, so as to deliver long term growth in value for both partners. Joint ventures can include contractual agreements, for example licences, profit and revenue sharing agreements, or formal corporate joint venture with one or more public or private sector partner.</td>
<td>To exploit the latent potential of government assets, and to share the risk of delivering policy objectives and where appropriate, commercial objectives as well, while enabling the public sector partner to retain on-going involvement and share in the financial benefits of the project.</td>
<td>Judging when to use joint ventures rather than more conventional partnerships, and how to create the right balance of risks and rewards for the public and private sectors. Structures need to work commercially, and be sufficiently robust to withstand public scrutiny.</td>
</tr>
<tr>
<td><strong>Partnership Investments</strong></td>
<td>Partnerships in which public sector contributes to the funding of investment projects by private sector parties, so as to ensure that the public sector shares in the return generated by these investments.</td>
<td>The original rationale for these programs was to try and overcome market failure by providing finance for projects with commercial potential but where the size, risk, or time scale of the investment, or political context mean that the capital markets are unable fully to fund the costs. Redefining these programs as partnership investments allows the taxpayer to share in the future returns from the project.</td>
<td>To ensure that such investments offer value for money, and in particular that the terms of the investment provide the public sector with returns commensurate with the risks it is taking on.</td>
</tr>
<tr>
<td><strong>Policy Partnerships</strong></td>
<td>Arrangements in which private sector individuals or parties are involved in the development or implementation of policy.</td>
<td>To introduce new thinking and relevant experience in the resolution of long-standing policy problems and in meeting the innovative challenge of modernizing government.</td>
<td>Culture and openness to change. Developing policy through partnership means challenging traditional ways of doing things and traditional assumptions of what needs doing.</td>
</tr>
</tbody>
</table>

(Source: Smith, pg. 46-48)
Appendix 2 - Examples of P3 Case Studies

The following four P3 case studies were prepared by Michael Trottier and Jeffrey Maguire for the Saskatchewan Institute of Public Policy, Public Policy Paper #4, in 1999. They have been provided here in their entirety for the reader as examples of infrastructure P3s. For an example of a collaborative social service type P3 and a detailed discussion of the issues of governance the book "New Players, Partners and Processes: A Public Sector Without Boundaries?" edited by Meredith Edwards and John Langford is recommended.

Case 1: The Confederation Bridge/ PEI Fixed Link (Build-Own-Operate-Transfer)

The Canadian federal government required a consortium to Build, Own, and Operate the Confederation Bridge project for a specified period, with title to the bridge to Transfer to the government at the expiration of that period.

| Desired outcome | The private-sector consortium was responsible for building, owning and operating the infrastructure in exchange for the right to generate revenue by levying user charges. These responsibilities of the private partner would continue throughout the term of the agreement until the final transfer of ownership to permit the construction of a major capital facility without increasing the level of public expenditure or indebtedness. |
| Environment driving the agreement | Since 1873 Canada has had a constitutional obligation to provide continuous access between PEI and the rest of Canada. Increasing fuel costs and capital expenditures necessary for upgrading ice-breaking vessels had made a fixed link an attractive alternative for the federal government. In March 1998, at the time of the request for proposals, the federal government was intent on reducing budgetary deficits and its level of indebtedness. |
| Terms of the arrangement | Partnership between the federal government (Public Works and Government Services), Atlantic provinces (PEI, Nova Scotia, and New Brunswick), and the private firm, Strait Crossing Development Inc (SCDI). The basic responsibilities of SCDI were to design, build, operate (and therefore maintain), and, finally, to transfer the facility. Responsibility for raising capital for the project rested with SCFI. The entire cost of the project was estimated to be $1 billion. The federal government demanded a security package from the contractor including: |

---

Adding Value: An audit reference manual on Public-Private Partnerships • 95
▪ a $200 million performance bond;
▪ a $74 million letter of credit;
▪ a $20 million labour and materials payment bond;
▪ a $5 million compliance assurance/regional benefits bond;
▪ a $35 million compliance bond;
▪ a $5 million interim maintenance assurance provision obligation;
▪ a $10 million fisheries-compensation obligation;
▪ a $30 million (annual maximum) reimbursement for ferry costs for completion delays; and
▪ $1.5 billion as a floating charge.

Commencing on May 31, 1997, the federal government was required to make annual payments of $41.9 million (in 1992 dollars, indexed to inflation) to a bond trustee for a term of 35 years. These payments secure the service charges on debt used to finance the project. Had the bridge not been operational by May 31, 1997, SCDI would have been responsible for funding the Cape Tormentine-Borden ferry service for a maximum of three years.

The federal government incurred direct costs including $46 million for project development, $41 million for improving highways, and $15 million for regional development to PEI and New Brunswick. The $661 million (including provision for a ten-percent contingency) that was raised initially by the issue of real-return bonds was transferred to an interest-earning project trust account from which disbursements were made to finance SCDI's up-front construction costs. Subject to the consent of an Independent Engineer, further disbursements were made to SCDI based upon the percentage of completion.

Upon completion of construction, the developer receives revenue in the form of tolls for 35 years. It was agreed that the toll rate would be calculated as the 1992 rate for ferry crossing adjusted by the Consumer Price Index up to 1997. Increases in the toll rate following May 31, 1997 could not exceed 75% of increases in the Consumer Price Index. The federal government leased shoreline property to the developer for the duration of construction and the period of developer operation for toll plazas and operations.
buildings. Safety and day-to-day maintenance of the bridge-including cleanup and snow removal-is solely the responsibility of the operator. At the end of the 35-year contract, ownership of the bridge is transferred to the federal government.

Identification and allocation of risks

SCDI is exposed to the risks associated with:

- construction (i.e., cost overruns, construction delays, and belated availability); and

- operations such as uncertainty in future maintenance costs, variability in traffic (service volume), regulatory changes in toll rates, and third-party claims.

The government is subject only to 'Project Risk Events' (i.e., acts of the Queens enemies, nuclear events, and environmental injunction) and 'Project Delay Events' (i.e., catastrophic events, third-party strikes and labour disputes).

Benefits and costs

The federal government's irrevocable annual payments to SCFI (utilising funds that were previously used to subsidise the ferry crossing) permitted a lower cost of capital than would have been obtained otherwise. Essentially, the irrevocable payments provided a stable stream of revenue that SCFI could use to service its debt obligations, thereby minimising the risk of default and the risk premium required by capital markets. The developer receives revenue from the user charges received.

For commuters the most obvious benefit is the significant reduction in time spent travelling between PEI and the mainland. The economic value of reduced travelling time for the users of the bridge is estimated to be $398.4 million (in 1993 dollars). Furthermore, it has claimed to have increased local business competitiveness in the region as well as promote tourism on PEI. Whether fortuitously or not, the timing of the project provided some mitigation of the employment difficulties arising from the severe decline in the fishing industry.

Outcome

The office of the Auditor General was satisfied with the procurement strategy used in the project. However, the Auditor General was critical of the contractual arrangements in the financing of the project and found that borrowing costs could have been $45 million lower had capital been raised directly by Canada rather than by SCFI. Specially, additional costs of $38 million were incurred on the 40 basis-point differential between Canada's and SCFI's real-return bonds. The remaining $7 million was attributed to additional underwriter's commissions.
The Financial Administration Act requires that the payment of any money pursuant to a subsidy is subject to there being an annual parliamentary appropriation for that purpose. Due to this requirement, the Northumberland Strait Crossing Act was introduced in 1993 to allow the government to redirect funds to the financing company (SCFI) in lieu of the ferry subsidy. The Northumberland Strait Crossing Act ensured that bondholders would receive a future stream of repayments. Although the government originally anticipated the transaction would take place 'off-balance sheet,' the Auditor General later ruled that the federal government must record the stream of payments as 'on-balance sheet' item. Despite the fact that the bonds are not the obligations of, or guaranteed by the Government of Canada, the stream of payments to the financing company will continue to be a liability until the termination of the agreement.

In addition to allowing the federal government to appropriate annual payments, the Northumberland Strait Crossing Act also provided the necessary authority to enter agreements and lease the federal real property required for the project (e.g., the lease of land used for toll plazas).

Potential P3s should incorporate a transparent procurement process. Although the government received three unsolicited proposals in 1986 and contract negotiations did not end until October 1993, the Auditor General found the procurement process to be transparent and reasonable. In particular, the government procurement method resulted in technical performance requirements being established in the first step, three private developers bidding on the security package and price, and well-qualified external specialists being utilised in the project and negotiating teams.

Contracts should safeguard all stakeholders' interests. While the government imposed regulations on the tolls that the operator could levy against the public, SCDI's interests were safeguarded with the stipulation that the government must not compete with the project.

**Case 2: Municipal Library, Scarborough Ontario (Build and Transfer)**

This project was a contribution contract in which the city received free land and a capital contribution towards a required library, together with some related construction, in return for providing a private developer an increase in housing density.
<table>
<thead>
<tr>
<th>Desired outcome</th>
<th>Contribution contract providing:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• an up-front reduction in capital costs;</td>
</tr>
<tr>
<td></td>
<td>• a contribution of private land for an accessible public library; and</td>
</tr>
<tr>
<td></td>
<td>• an increase in the permitted housing density for the private partner’s apartment project.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Environment driving the agreement</th>
<th>The Library Board was looking for space for a new library in northwest Scarborough, a suburb of Toronto. The municipality could not find reasonably priced land in a preferred location. A partnership with a developer would provide access to privately owned land in a desired location.</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Terms of the arrangement</th>
<th>The partnership comprised Tridel Developments (operating as Sumeru Construction Inc.), landowner Mundet Industries Limited and The City of Scarborough. Tridel agreed to transfer land to the Library Board and contribute a cash payment of $500,000. The developer also agreed to fund and/or undertake several other projects in the area such as landscaping, road improvements, and day-care facilities worth, with a total value of $1.6 million.</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Identification of risks</th>
<th>The private partner is subject to the risk that the public infrastructure necessary to serve the new development may not be built at the optimal time.</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Benefits and costs</th>
<th>Increased density for housing development was conditionally granted. The agreement allowed the developer to avoid the usual development hearings before the Ontario Municipal Board, which can cause delays of up to one year. Additional costs can include legal and planning fees of approximately $500,000. As a result, the developer benefited from a timely process that allowed it to get its housing units to market while that market was still active. Knowing the terms of the partnership, the private partner also benefited from more certain cost predictions. The City acquired the private land required, reduced capital costs, received extra services and facilities surrounding the library, and increased its revenue through the new housing units.</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Outcome</th>
<th>The Agincourt library has been built and the housing development was half built and occupied approximately 4 years later.</th>
</tr>
</thead>
</table>

| Lessons learned | In the absence of municipal development costs, municipalities can successfully negotiate for public benefits as a condition of granting higher residential densities. |
Case 3: Light Rail Transit in the Philippines (Build-Lease-Operate-Transfer)

For the Light Rail Train 3 (LRT3) in Manila, the consortium was required to finance and build the infrastructure necessary for the project. Upon completion, the infrastructure was leased to the government. Its maintenance, however, is the responsibility of the consortium. At the end of the contract, the infrastructure will be transferred to the government.

A private-sector consortium is invited to build and finance the required infrastructure, which is then leased to the Philippine government for the operation of the light rail system, with the title of the infrastructure being transferred to the government after the lease-term.

The Epifanio de los Santos Avenue in Metro Manila is considered to be one of the most over-utilized roads in the world, with an estimated daily utilization of 300,000 vehicles carrying more than 2.8 million passengers. The government has planned since 1989 to construct its third Light Rail Train System (LRT 3) in the expectation that it would relieve traffic congestion by transporting more than 600,000 passengers per day.

On October 31, 1996, the Philippine’s Department of Transportation and Communication solicited bids for the LRT 3 project and the winning consortium, MRTC, consisted entirely of domestic partners. The consortium consisted of Fil-Estate Management, Ayala Land (subsidiary of a local bank), Anglo-Philippine Holding Corp., and Ramcar with an equal 18.6% equity in the project. Other equity holders included Greenfield Development Corp (16%) and Allante Reality (9.6%).

MRTC made an equity investment of $190 million U.S. in the LRT 3, and sought the assistance of JP Morgan in raising $465 million U.S. in debt from Credit Suisse, Bank of Tokyo, Japan Export-Import Bank, Czech Export Credit Agency, and four domestic banks. MRTC entered into an agreement with the construction contractor—a joint venture between Sumitomo Corp. and Mitsubishi Heavy Industries Inc.—two weeks prior to the signing of the Build-Lease-Operate-Transfer agreement with the government. The construction costs of the tracks and stations totaled $361 million U.S. Sumitomo and Mitsubishi were required to provide $70 million U.S. in a bank guarantee and two performance bonds of $23 million U.S. which would be forfeited in the event of breach of contract. They were also accountable for $231 million U.S. in limited liquidation damages. Furthermore, in the event of failure-defined
as the government being required to complete the LRT 3 project-the consortium would forfeit their $190 million U.S. equity in the project. The Philippine government essentially guarantees a 15% return on equity to the consortium.

Upon completion, the government will provide the service and operate the system while paying a fixed lease to MRTC for use of the LRT 3 infrastructure. In return for receiving lease payments (that cover the debt-servicing, costs of maintenance, and the specified 15% return on equity) over a 25-year term, the consortium must maintain 17 stations, 73 light-rail vehicles, and 16.8 kilometres of track. At the end of the 25-year term, the consortium must pass the title of LRT 3 project over to the Philippine government.

Since the government provides the service it accepts (and controls) all risks associated with uncertainty in volume, fare rates, variable input costs (fuel and labour), and consequently, profitability. In addition to the construction risks, MRTC accepts the risks associated with operating the system in terms of uncertainty in the costs of maintaining and repairing the infrastructure (at least until ownership is transferred to the public sector).

In the negotiation of the agreement, the government provided a 'letter of undertaking', which provided lease payments sufficient to cover the 15 per cent return on equity and service the debt of the consortium, thereby relieving the consortium of the normal risk of debt financing. The government therefore did not avail itself of the opportunity provided by the P3 to transfer financing risks to the private-sector partners. As discussed below, however, the 'letter of undertaking' did produce some compensating benefits.

Since the government has secured the debt that the consortium has issued for the project, funds were easily attained from foreign lenders. Had the consortium been required to finance the project without the benefit of the guarantee implicit in the letter of undertaking, financing costs would have been appreciably higher. This, in turn, would have meant higher project costs to the government, the difference having been estimated to be approximately $100 million U.S.

The consortium members stand to gain ancillary benefits from the arrangement vis-à-vis lucrative real-estate deals. For example, the LRT 3 complements a Fil-Estate residential development project in the connected city. Upon completion next year, the LRT 3 will provide Manila residents with an alternative means of efficient, affordable and safe transportation. The private partners also initiated an additional investment in commercial structures along
the new rail systems to increase the project's economic viability (which was not required in the agreement).

The government had decided that the LRT 3 would be the last in which it participates in a build-lease-operate-transfer scheme. A French consortium had placed an unsolicited bid for involvement with the LRT 4, which links Manila to neighboring Quezon City. In light of what it learned from the LRT 3 project, the public sector was in favour of a Build-Operate-Transfer arrangement, whereas the consortium favored the same arrangement as MRTC. As a compromise, both parties are considering a Build-Transfer-Operate.

An inherent trade-off exists in this particular Build-Lease-Operate-Transfer arrangement between the level of lease payments and exposure to uncontrollable risks. Proponents argue that the project would not have received debt at the very low interest rate without the commitments granted in the letter of undertaking. On the other hand, critics argue that the government accepted too many risks, especially financial risks linked to project completion. It is difficult to determine whether the government accepted too many risks as a result of the letter of undertaking or as a result of the agreement. The Philippine government will likely use Build-Operate-Transfer or Build-Own-Operate-Transfer arrangements for future P3 projects.

Since the operation of LRT3 is in the hands of the government, it may be argued that the contractual arrangements failed to provide incentives for the minimization of operating costs at design and construction stages. This is not the case with maintenance costs. Since the consortium is responsible for the maintenance of the entire system, including rolling stock, a whole-life approach was adopted in respect of design, construction and maintenance, and this should result in the minimization of construction and maintenance costs over the life of the project.

**Case 4: Richmond Ice Centre (Build-Lease-Operate)**

This project involves the public utilization of private land and capital for the construction of a recreational ice-rink facility. The public partner will lease and operate the rink for twenty-five years. The private partner benefits by gaining an anchor tenant in its proposed business park.

A build and lease arrangement to provide municipal access to private capital and land and the provision of a large municipal recreation centre; and attract tenants to a proposed private sector business park.
The City of Richmond needed 14 acres of land plus room for expansion and parking. Initial proposals for construction on public lands were estimated to cost $30 million. The actual project cost utilizing private capital and lands was $15 million. Of the several initial proposals received, all required the use of City land. Riverside Business Park Inc. proposed the use of its privately owned land in an industrially zoned area. It wanted an anchor tenant that would help attract other tenants to its proposed business park. Richmond City Council gained public support for a 25-year lease through a referendum.

The developer provides capital, use of private land, and constructs a four-rink complex on private land and leases it to the city for 25-years receiving lease payments of $1.4 million per year for the first five years, with increases in consistent with the consumer price index thereafter.

The city and a non-profit Richmond Arenas Community Association will operate the arena. The association to return 100% of the costs and expenses incurred by the City associated with the operation of the arena, and the City will pay the yearly lease costs. The Association will retain the first $25,000 in net profit annually, and any profit above that will be split 25% to the Association and 75% to the City. The City's portion will be put into a replacement fund so that at the end of the lease the City could have the money to build a new facility, buy the existing one, or continue to lease it.

The community risks the loss of its arena at the end of the lease. The developer is committed to the provision of the facility but has no guarantee of attracting the desired tenants for the business park.

The private developer obtains a guaranteed long-term anchor tenant to attract potential clients in the proposed 35-acre Business Park. The city gained a new arena, which is operational five years earlier than if it had financed and built the facility itself. In addition, there will be an increase of two ice surfaces over what was originally proposed. The new facility will provide a state-of-the-art recreation facility for all the residents of the municipality. Tax increases to pay for the centre are minimized and the city saves on capital costs and land.

The objectives of the public sector were met and exceeded by gaining private land and capital, and a new facility five years earlier than initially possible with twice the capacity. The use of private land and capital increased the value-for-money to the city. The increased capacity provided an opportunity for the facility to draw revenues from other areas that required the use of ice surfaces.
Appendix 3 – Discussion of the UK Public-Sector Comparator experience

The following discussion of the Public Service Comparator was prepared by Dr. John Allen and included in his Public Policy Paper No. 4 "Public-Private Partnerships; A Review of Literature and Practice" for the Saskatchewan Institute of Public Policy, pages 21-22. The discussion is based on experiences with the PSC in the UK and is reproduced here in its entirety for those wanting a more in depth understanding of the PSC and its use.

A PSC is a benchmark created for the purpose of demonstrating value for money. As used in the UK PFI, it is a detailed benchmark the compilation of which may require the investment of considerable time and effort. This characteristic has led to it having a somewhat chequered career: initially, it was required of all PFI initiatives, but the time required to prepare the comparators contributed to substantial delays in being able to respond to private-sector bids. The strict requirement for it in all cases was therefore relaxed, particularly in circumstances in which strong competitive bidding was operative.

Most recently, however, the UK Private Finance Treasury Taskforce has reiterated the requirement that a public-sector comparator be prepared as part of the preparation of a PF initiative, except in the case of "free standing projects" in which there is virtually no contribution of public funds. Additionally, in situations where the public sector is not the major supplier of funding, the comparator analysis may be dispensed with, although VFM will still have to be demonstrated vis-à-vis alternative uses for those public funds that are invested in the project.

As utilised in the PFI, the preparation of the comparator is a two-stage process. An early requirement in the PFI process is the compilation of an "Initial Business Case", the purpose of which is to demonstrate the likely viability of the initiative. A component of this is the "Reference Project", which is used to demonstrate that an affordable investment option exists. This involves a basic costing of one possible solution to the procurement need. The second stage involves the preparation of a detailed public-sector comparator (PSC) which, in practice, is likely to be a refinement of the reference project. While related, the two steps are distinct and serve different purposes: the reference project is a critical step in demonstrating that the project is affordable, while the PSC will provide the necessary evidence that a particular option represents good value for money.

In most cases, the two most likely alternatives to a PFI procurement process will be (1) conventionally funded provision of the same level of service; and (2) conventionally funded provision of a lower level of service, the actual level being determined by the funds available. Whichever is used, the PSC must reflect the full cost of providing the services. In the absence of a fully articulated comparator process, it is unlikely that a full costing would be achieved: governments rarely measure the cost of providing services in-house. Many overheads-such as the costs of central agencies and those of financing-are seldom allocated, and, as noted above, self-insurance tends to militate against any proper costing of risks.
The construction of a PSC is seldom straightforward. It will typically be based on a set of hypothetical contracts to design, build and manage a public-sector facility, based on recent experience of actual costs. It must provide for the fact that outcomes are frequently more costly than anticipated. Estimates will be required both of the likely costs and the risks associated with acquiring and then operating an asset to provide a service that meets specified standards. Where the service in question is a new one, one for which no readily available comparisons are available, it may be necessary to construct a proxy measure or benchmark. This is likely to require an initial identification and costing of risk, a process that may be unfamiliar to relevant staff in the government department or entity involved. It must be appreciated, however, that private-sector submissions on a prospective P3 project will price and include the costs of carrying and managing transferred risks; it is essential, therefore, that the PSC for the project also include these costs.

More generally, in using a PSC it must be appreciated that private-sector bidders are bound by the financial consequences of their bids in a way that government officials seldom are. This can result in excessive optimism in the PSC analyses, and this must be guarded against. It must also be appreciated that large-scale public-private partnerships may generate significant externalities that will benefit an entire regional economy, but which cannot be captured by the partnership through charges imposed on the users of the project. Such externalities should be reflected in the PSC and may warrant the infusion of public funds to supplement the revenues that can be generated directly by the project.

The UK experience with the PFI would suggest that there have been difficulties resulting from attempts at excessive refinement of PSCs. Such attempts are subject to diminishing returns and have contributed to excessive delays in responding to private-sector bids on PFI projects. This was considered unfair to private-sector bidders, most particularly when the refinements went appreciably beyond the information that had been conveyed initially to the private sector. In consequence, the Private Finance Taskforce has mandated that attempts to refine PSCs must be constrained by the incremental value that results from the additional efforts and by the availability of comparators from prior similar procurements.

Standard procedure in the UK PFI would see bids from the private sector sought when the preliminary option appraisal has been completed and the scope of the project defined, but prior to the detailed refinement of the PSC. The Taskforce is of the opinion that vigorous competition between potential suppliers is the surest method for obtaining the best possible offers from the private sector. This increases VFM and also the probability that the best PFI bid will in fact provide better VFM than the PSC. It must also be recognised, however, that the preparation of PFI bids may be an extremely expensive process, particularly in the case of very large-scale projects. In consequence, the Taskforce and the Government are committed to minimizing the costs incurred under the PFI. Pre-qualification and limiting the number of potential bidders to no more than is necessary to sustain competition are among the techniques used for this purpose.
The PF Taskforce also encourages government departments and agencies to be as open as possible with bidders. This helps private-sector bidders avoid incurring costs unnecessarily and minimises misunderstandings respecting required levels of service and operative budget constraints. The implication of this is that information regarding the conceptual basis of the relevant comparator should be disclosed, together with technical information on the methodology of its construction. Indeed, where competition is strong, the Taskforce is of the view that it may be appropriate to share the full outcome of the PSC exercise with the bidders.
Appendix 4 – Procurement Attestation Audit Framework

Selection of a partner involves planning the selection process, soliciting proposals, evaluating proposals, and selecting the successful proponent. P3s often involve large amounts of money and long-term relationships. In addition, the costs to the bidders or preparing proposals for P3s are significant. Therefore, the consequences of the partner selection process being perceived by the potential bidders as biased or unfair can be serious. If potential bidders perceive the procurement process as potentially unfair they will not participate and government may not receive the best proposals. If unsuccessful proponents perceive the process as unfair or biased they may take legal action increasing costs to government in defending the process or in settlements.

Purpose

The purpose of a procurement attestation audit is to ensure contracting practices are fair and effective.

Potential Risks

The primary risk in the procurement process is that the best proposal is not received or selected due to:

- a lack of fair access to competition by qualified bidders;
- inconsistent procurement practices;
- unclear instructions to proponents;
- ineffective or biased evaluation criteria;
- disclosure of confidential information;
- inconsistent or biased evaluation of proposals; or
- inappropriate changes to proposals during the negotiation stage.

The following sets out some possible audit objects, criteria and procedures for use in a procurement attestation audit.
<table>
<thead>
<tr>
<th>Objectives</th>
<th>Criteria</th>
</tr>
</thead>
</table>
| **To assess the effectiveness of the RFP planning process.** | • Project parameters for the P3 and the attributes of a potential partner have been appropriately defined.  
• Procedures to ensure the fairness and effectiveness of the procurement process are in place.  
• There is a procurement plan in place and the plan contains all significant steps, milestones and controls for the RFP process.  
• Preliminary evaluation criteria have been documented and assessed.  
• A procurement team has been selected that includes members who are independent to the P3 project. For example, staff from the purchasing commission are on the evaluation team.  
• Adequate steps have been taken to identify private sector partners capable of providing the required service. |
| **To assess the appropriateness of the evaluation criteria.** | • Specific criteria seen as important to the success of the P3 have been identified.  
• The rationale for the criteria selected has been documented.  
• The criteria selected match/demonstrate the attributes required of an ideal potential partner to complement the attributes of the government partner, given the goals and objectives of the P3.  
• Appropriate financial, cultural, technical, and performance specifications have been developed for proponents to clearly demonstrate their abilities, experience and fit with the established criteria.  
• A scoring and weighting system has been adequately developed and the weightings are consistent with the importance of the criteria.  
• The weighting and scoring system has been tested to ensure potential proposals that best meet the desired attributes will score the highest. |
| **To assess the effectiveness of the RFP document.** | • The instructions to proponents contained in the RFP are clear and understandable.  
• Deadlines for submission of proposals and any informational sessions are clearly set out in the RFP.  
• Mandatory and preferred criteria or requirements are clearly set out in the RFP.  
• All criteria and methodology for evaluating proposals are clearly set out in the RFP.  
• The RFP has been released to all identified proponents in an appropriate manner.  
• There is a well-communicated method to provide clarification of information to potential bidders and that the information provided to one bidder is also made available to others.  
• There is a process in place to track and appropriately control the proposals received.  
• Sufficient controls are in place and communicated to ensure the privacy of confidential information submitted by proponents. |
<table>
<thead>
<tr>
<th>Objectives</th>
<th>Criteria</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>To assess the fairness of the evaluation process.</strong></td>
<td>• Procedures for evaluation of proposals were established and followed.</td>
</tr>
<tr>
<td>udeau: An audit reference manual on Public-Private Partnerships ● 109</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• There was appropriate opportunity for public viewing of and comment on proposals when required.</td>
</tr>
<tr>
<td></td>
<td>• An independent person observed the evaluation process.</td>
</tr>
<tr>
<td></td>
<td>• Specific requirements for ranking the parts of the RFP have been established and communicated to ensure consistency among the evaluation team.</td>
</tr>
<tr>
<td></td>
<td>• Proposals were appropriately evaluated and ranked according to the specifications and criteria outlined in the request for proposals.</td>
</tr>
<tr>
<td></td>
<td>• Proposal evaluations and the rationales for the scores were documented and signed by the evaluators.</td>
</tr>
<tr>
<td></td>
<td>• A process was in place and followed to ensure consistency in verifying proponent references.</td>
</tr>
<tr>
<td></td>
<td>• The proponent offering the best proposal as determined by the evaluation was recommended for approval.</td>
</tr>
<tr>
<td><strong>To assess the fairness of the award and contract negotiation processes</strong></td>
<td>• Procedures for negotiation and award of the contract are in place.</td>
</tr>
<tr>
<td></td>
<td>• Unsuccessful proponents have been appropriately notified of the government's intent to enter into negotiations and a contract with the successful bidder.</td>
</tr>
<tr>
<td></td>
<td>• Negotiation of the contract does not significantly alter the terms and conditions of the RFP or the proposal.</td>
</tr>
<tr>
<td></td>
<td>• The contract or partnership agreement was awarded to the proponent offering the best proposal as determined through the RFP evaluation process.</td>
</tr>
</tbody>
</table>
### Appendix 5 - Value for money in a private sector financing partnership procurement - Applying the NAO framework

The following framework adapted from the NAO framework provides guidance on objectives, criteria and procedures an auditor should address in order to gain reasonable assurance that the procuring organization has achieved value for money through its partnership arrangement.

<table>
<thead>
<tr>
<th>Objective</th>
<th>Criteria</th>
<th>Procedures</th>
</tr>
</thead>
<tbody>
<tr>
<td>How the department made the project objectives clear</td>
<td>The best project was selected.</td>
<td>Examine how possible projects were prioritised and identify whether only the top priority projects were selected.</td>
</tr>
<tr>
<td></td>
<td>The project deliverable are clear</td>
<td>Determine whether the desired results were expressed in output terms. Review whether a preliminary assessment of the private sector's capabilities for delivering their requirements was made. Identify whether a preliminary evaluation of the benefits sought was done and criteria for the evaluation of the benefits established. (possible evaluative criteria could include value for money, bidder reputation and financial stability, bidder operational skill and technical capacity, degree of risk transfer etc.) Review how the weightings to be attached to the various project or policy objectives was assessed.</td>
</tr>
<tr>
<td>Objective</td>
<td>Criteria</td>
<td></td>
</tr>
<tr>
<td>-----------</td>
<td>----------</td>
<td></td>
</tr>
<tr>
<td>The best form of partnership was determined</td>
<td>Examine whether a feasible project mechanism was identified. (alternative mechanisms may include privatization, contracting, private financing, joint venture, P3) Review whether the room for innovation in advance was identified. Investigate whether the scope of risk transfer was identified in advance. Examine how the likelihood of a project that was affordable and offered value for money was established.</td>
<td></td>
</tr>
<tr>
<td>A business case was completed</td>
<td>Examine the Business Case in detail.</td>
<td></td>
</tr>
<tr>
<td>How the Department applied the proper project management processes</td>
<td>The procurement was planned properly</td>
<td>Examine whether a properly qualified project team was assembled in a timely manner. Examine how the market was investigated to ensure there were suppliers willing and competent to bid for the project. Examine whether the likely contractual issues were identified. (For example, length of contract, risk allocations, payment mechanisms, incentives, service levels, performance monitoring, change mechanisms, asset transfer, residual value, sanctions, and audit access) Identify whether a tendering strategy and timetable was prepared. Identify whether a credible project timetable was prepared. Examine whether a public sector comparator was prepared and assess its adequacy.</td>
</tr>
<tr>
<td>Objective</td>
<td>Criteria</td>
<td>Procedures</td>
</tr>
<tr>
<td>-----------</td>
<td>----------</td>
<td>------------</td>
</tr>
</tbody>
</table>
| Conditions for a successful competition were established. | Examine whether a good tender list was created.  
Consider whether good specification of government requirements was created.  
Identify whether a competitive tension was maintained up to contract award. | |
| The value of the project was regularly reassessed. | Identify whether the value of the project was regularly reassessed. (Key points for reassessment would include, prior to announcement of preferred bidder, when the business case is developed, and before signing the contract) | |
| Costs were controlled. | Examine whether realistic budgets were set.  
Check that the advisers were appointed after a competitive process.  
Review how costs are monitored and managed | |
| Whether the Department selected the best available deal | A good range of solutions was received from proponents (i.e., innovation was encouraged). | Examine whether the range of solutions proposed included  
· design variants.  
· operational variants.  
· financing variants.  
· deliverable variants.  
· risk transfer variants. |
<table>
<thead>
<tr>
<th>Objective</th>
<th>Criteria</th>
<th>Procedures</th>
</tr>
</thead>
<tbody>
<tr>
<td>The most economically</td>
<td>The most economically advantageous bid was selected based on a fair and</td>
<td>Determine whether the proposals/bids were evaluated using consistently applied evaluation criteria.</td>
</tr>
<tr>
<td>advantageous bid was selected based on a</td>
<td>reasonable evaluation.</td>
<td>Review evaluation documentation for clearly documented rationale for selection of preferred bidder.</td>
</tr>
<tr>
<td>fair and reasonable evaluation.</td>
<td></td>
<td>Review how the most economically advantageous bid was selected.</td>
</tr>
<tr>
<td>Differences between winning bid and final</td>
<td>Differences between winning bid and final contract were managed to ensure</td>
<td>Review how any changes in the risk allocation between the winning bid and the final contract were managed.</td>
</tr>
<tr>
<td>contract were managed to ensure process was</td>
<td>process was fair.</td>
<td>Examine the management of any other changes between the winning bid and the contract. E.g. What if costs were added in negotiations?</td>
</tr>
<tr>
<td>fair.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>How the Department made</td>
<td>The project meets and will continue to meet its objectives</td>
<td>Examine whether the deal meets the projects original objectives and the latest circumstances.</td>
</tr>
<tr>
<td>sure that the deal made sense</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Alternatives were evaluated and fairly</td>
<td>Alternatives were evaluated and fairly eliminated</td>
<td>Review whether:</td>
</tr>
<tr>
<td>eliminated</td>
<td></td>
<td>· all reasonable alternatives were examined,</td>
</tr>
<tr>
<td></td>
<td></td>
<td>· the preferred option was the most economic</td>
</tr>
<tr>
<td></td>
<td></td>
<td>· there was a clear overview confirming the desirability of proceeding with the best deal.</td>
</tr>
<tr>
<td>The contract will ensure delivery</td>
<td>The contract will ensure delivery of the services over its life.</td>
<td>Review whether:</td>
</tr>
<tr>
<td>of the services over its life.</td>
<td></td>
<td>· the contract is consistent with the negotiated deal,</td>
</tr>
<tr>
<td></td>
<td></td>
<td>· the contractual arrangements are accurate, the termination and hand-over procedures clearly specified,</td>
</tr>
<tr>
<td></td>
<td></td>
<td>· there are appropriate sanctions and bonuses,</td>
</tr>
<tr>
<td></td>
<td></td>
<td>· the contract is capable of dealing with changes in requirements.</td>
</tr>
<tr>
<td>The arrangement is affordable in the short</td>
<td>The arrangement is affordable in the short and long term.</td>
<td>Identify whether there are sources for any capital funds required and for the on-going payments payable under the contract.</td>
</tr>
<tr>
<td>and long term.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Adding Value: An audit reference manual on Public-Private Partnerships ● 113*
Appendix 6 - IOSAI/NAO P3 Value for Money Audit Guidance

The following framework was compiled from the guidance developed by the International Organisation of Supreme Audit Institutes for auditing private finance concessions and the analytical framework for examining value for money of P3 agreements developed by the UK National Audit Office.

The following guidance has been adapted to IAAS terminology and does not have to be used in its entirety, relevant sections, objectives or audit steps can be selected based on the scope of the given audit project and the P3's life-cycle phase. The guidance is presented in six sections from the general approach through to contract management.

Section 1 - General Audit Approach

- Identify the possible scope and objectives of the P3 audit and consider what approach would be the most suitable and add the most value for the client.
- Examine the public/private finance concessions deal as soon as is practical and gather all available background information.
- Identify key skills or areas of specialization that will be needed to carry out the P3 audit. The audit team should be selected based on the skills required; contractors or consultants should be hired as necessary. Consultants could be hired for technical advice in the business area involved, legal advice, advice in commercial financing and advice on technical aspects of the real property involved.
- In planning the P3 audit the auditor should plan to cover all major aspects of the arrangement that have a bearing on the value for money. The auditor should examine the P3 objectives, key criteria for success and the views of those who negotiated the arrangement. The key parties with an interest in the P3 should be identified and their views sought. This would include all bidding firms, topics that could be discussed are the project deliverables, the bidding process, the perceived attitude to innovation, the tendering requirements, costs in presenting bids, risk allocation, the fairness of the process and the bidders' willingness to tender for future P3 deals.

Section 2 - Value for money in the selection of a P3

This section covers the auditor's examination of how a procuring ministry decided the scope of the P3 project. The auditor should also examine how the ministry structured the project to meet their strategic and service plan goals and the role the ministry's assessment of the private sector capabilities had in shaping this structure.

- Examine how the ministry prioritized potential P3 projects and whether it implemented projects in that priority order. The strategic planning needs to show a clear need for the services eventually procured. P3s can be very attractive to
public sector ministries since it allows them to undertake projects they might have been unable to finance. This creates the risk that the ministry's priorities may be distorted in favour of those projects that are capable of being P3s against those which meet the ministries real needs.

- Examine whether the ministry stated the project requirements and objectives clearly from the start and expressed these in terms of deliverables. No limit should be placed on the delivery method so possibilities for innovation are maximized. Flexibility in the level of service and usage is desirable to avoid paying for unnecessary services.

- Review the ministry's preliminary assessment of market feasibility to assess the private sector's capabilities for delivering the requirements and to ensure there are sufficiently suppliers who were willing and competent to bid for the work to ensure adequate competition. This could include evaluation of the bidder's reputations, financial expertise, specialized knowledge, abilities and technical capacity.

- Identify whether the ministry made a preliminary evaluation of the benefits it sought. These benefits could include potential increases in innovation, value for money, services offered, service quality and risk transfer opportunities.

- Review how the ministry assessed the impact of any proposed changes in regulation or legislation might have on the project. When looking at expected return the taxation treatment should be included to ensure there are no dubious practices.

- Examine whether the ministry examined the full range of alternative service delivery methods and selected the most suitable form of partnership. Other options that could be considered are traditional procurement, contracting, joint venture and privatization. The rationale supporting the selection of the P3 option should be documented and well supported.

- Review whether the ministry identified possible room for innovation in advance in areas such as design and construction, operation and project financing. If limits have been placed on the project the justification for these limitations needs to be examined as they could limit possible innovations.

- Establish if a preliminary assessment of the risks and their possible transfer was completed. The ministry should have identified all risks such as the demand risk, the risk of fraud, the extent that risks are retained in the public sector, the contract renewal risk and the creation of secondary risks. Effective risk management is needed to identify each risk involved and who will take responsibility for this and a strategy for dealing with each risk should have been formulated.
Examine whether the ministry prepared a business case outline to support the decision to begin the project procurement. The business case should include project objectives (deliverables should be stated in output terms, the risk transfer sought should be defined and a budget limit should be set), the financing options should be appraised, a procurement strategy, project timetable and evaluation criteria should have been formulated. Also the business case should include a commitment from the ministry and stakeholders that the proposed project will be acceptable.

Examine whether the ministry prepared an appraisal of the potential value for money the P3 project represented and whether the project was likely to be affordable. This should include: an estimate of the likely capital and operating costs using traditional procurement; the economic impacts on the public sector if a P3 and concessions approach is used; the likely project management costs; the non-financial benefits; and, an assessment of the disadvantages of each option.

Section 3 - Value for money during project development

This section provides some audit steps to be considered in assessing whether value for money was achieved during the development of the P3.

Examine whether the ministry assembled a project team based on the skills identified as needed for the project to succeed in a timely manner. Good legal and financial advice is particularly important. Also, reporting and decision making procedures within the team should have been established. The team can consist of in-house staff and from external advisors and should have been assembled in adequate time for the project.

The ministry should have investigated the market prior to beginning the formal procurement to ensure that there were suppliers who were willing and competent to bid for the work, this could have been part of a market feasibility test. The auditor should ensure that the ministry determined there would be sufficient competition from the suppliers who were willing to tender for the project so that the best value for money could be achieved.

Examine whether the ministry identified the contractual issues that were likely to arise during the procurement and drew up a draft contract, setting out initial proposals for dealing with each issue. The main contractual issues are: the length of the contract; allocation of risks between parties; payment mechanisms and incentives; service levels and performance monitoring; convenient, change mechanisms; end of contract (asset transfer and residual value); sanctions; clawback arrangements; and, external audit access.
• Confirm that the ministry prepared a tendering strategy. This should identify the number of tender rounds to be held, the number of bids to be invited at each tender stage, the ministry's approach to communicating with bidders, and a realistic timetable for tender process. The tender rounds should be limited to minimize costs to the bidders. The process should allow for early discussions with bidders.

• Identify whether the ministry prepared a credible project timetable, which identified milestones against which progress should be measured, and points within the process at which the body was to review the project's continued viability.

• Was a public sector comparator established as part of the planning to later use as a benchmark against which to judge bids received? The business case prepared earlier in the process can be used as a framework for the comparator. Focus should be on the assumptions underlying the comparator and the variables that will have the most significant impact. Variables likely to be important are the financial impact of various risks, the discount rate used to calculate the net present value, and the forecasts for the volume of services required. The detail required in the comparator will depend on the impact the comparator is likely to have in the assessment of value for money.

• Examine whether the ministry assessed the project against any publicly funded alternative, and review the adequacy of this public sector comparator.

• Examine whether the ministry succeeded in creating a good tender list.

• Examine what actions were taken to stimulate the market; this can involve direct mailing to potential bidders, advertisement, contact with trade associations and holding a bidder's conference. A list of potential firms should be examined to ensure it included good quality firms. If a consortia is to compete for the work an assessment is needed of all consortia members to establish if a cartel exists. One of the best tests for whether the tender list provided sufficient competition is a review of the number of bids received.

• Consider whether the ministry set out a clear specification of the requirements. How the specifications where developed should be examined, expectations should be realistic and aligned with the ministry's real needs. Verify that the content of the specification was consistent with the project deliverables and specified the level of performance required by the contractor.

• Identify whether, through the establishment of a competitive final shortlist, the ministry succeeded in maintaining competitive tension until the contract award and managed the negotiations with the preferred bidder well. This is achieved by maintaining competitive tension through-out the process, this can be done by having target dates for each stage of the process, also short-listing companies during the selection process. The period for exclusive negotiation should be kept short by achieving as many improvements to the terms of the bid as possible before this stage.
• Identify whether during the procurement the ministry regularly reassessed that the project continued to offer value for money.

• Examine whether the ministry set realistic budgets for all project costs including the cost of internal and external resources.

• Check that the ministry appointed quality external advisers after the competition.

• Review how the ministry monitored and managed its project costs including internal and external resources.

Section 4 - Value for money during contract negotiation.

The purpose of this section is to provide some audit steps to assess whether the negotiation of the final contract appropriately transferred risk and that value for money is still being achieved.

• Examine whether the range of solutions proposed by bidders included design variants.

• Review whether bidders put forward operational and deliverable variants in their proposals. Differing service levels can create operational variants. Since public sector staff can be transferred as part of the deal the evaluation of the bids should have includes proposed arrangements for employees' pension, employment rights and union recognition transfer.

• Investigate whether decision-makers were presented with a range of plausible financial figures, under different operating and financial scenarios. Relative cost differences between the public and private sector should be drawn assuming the same level of performance. There needs to be an understanding of the source of all financial differences and the uncertainty surrounding the financial figures should be made clear. If extra efficiencies are claimed by the private sector the extent to which these are credible and why they may not be achievable should be considered.

• Investigate whether the bidders' proposals included different ways of financing the project. When assessing value for money the reasonableness of expected returns has to be assessed as well as the taxation treatment to ensure there are no dubious practices.

• Examine whether bidders suggested amendments to the requirements identified in the specification by the ministry. If amendments were made the auditor should confirm that the process was fair to other bidders.
Examine whether bidders submitted different proposals for the allocation of risk between private and public sector. The ministry's earlier sounding of the market should have enabled them to seek bids on the basis of risk allocation and value for money to avoid lengthy negotiations after the contract is signed.

Identify whether the ministry carried out an assessment of the financial aspects of bids and ranked them. Net present value should have been established for bids and the reasonableness of discount rate, future inflation and value of assets should be assessed. The ministry should have also reviewed the financial models used to prepare the bids. Failure to identify potential financial problems could result in higher over-all costs for bids. The auditors should complete their own review of the successful bidder's financial model, as it will assist in identifying value-for-money.

Examine how the ministry assessed the allocation of risk proposed by each bidder and its effect on the proposed contract price. The proposals should have been ranked according to risk transfer. The auditor should pay close attention to the payment regime in looking at allocation of risk as the two are closely linked. The level of risk transfer changes if there are only small variations to the service charge for poor service, unavailability and many allowances for service charge increases.

Confirm the ministry's assessment of the financial capabilities and stability of bidders, and the members of bidding consortia, is sound and complete.

Assess the ministry's evaluation of the quality of service proposed by each bidder.

Review how the ministry assessed the results of the financial and non-financial evaluation so as to select the bid offering best value. The ministry should have clearly documented their assessment of each bid and the reasons for choosing the preferred bidder. A guideline for evaluation should have been created and weighting should have been established this could include non-financial considerations, which are needed to assess value for money. These non-financial considerations could include past company performance, design features, operational feature and the impact of risk, the proposed contractual framework and incentive regime, how well the long-term partnering relationship between the parties can be established, which option will best ensure effective risk management and safety needs to be considered. The assessment method should have been consistently followed and should include a value for money assessment. Value for money is a combination of cost over the life of the project and quality, which meets an organization's requirements.

Review how the ministry minimized changes to the terms of the deal during the final negotiations. The scope of change should have been kept limited and one of the unsuccessful bidders could remain involved in case negotiations fail. Any changes should be evaluated in terms of value for money of the successful bid;
the price of the bid should not be changed. The contract should be examined by the auditor to verify the risk identification and allocation. The auditor should also ensure legal advice was sought and the bidders were treated fairly.

- Establish that roles, responsibilities and communication between the partners in the accountability relationships are clearly defined in the contract and are understood and agreed upon while supporting achievement of deliverables.

- Confirm that the contract established a control and reporting environment with mechanisms for public values and ethics and conforming to public sector standards. There should also be clear provisions of public access to information and responsiveness to public inquiries and concerns.

- Confirm that the parties had a shared vision of the project mandate, objectives, result and performance expectation and enter the agreement in the spirit of a partnership with a good understanding of each other's business.

**Section 5 - Value for money during evaluation**

The purpose of this section is to provide some audit steps for providing the ministry with assurance that the P3 arrangement will meet the objectives, and provides value for money prior to committing itself by signing a contract. In assessing value for money previous section should be used in addition to this section.

- Examine whether the arrangement meets the original objectives or the latest circumstances if these objectives changed during procurement.

- Examine whether the ministry confirmed that the proposed arrangement offered best value for money and maximized the potential for value for money, compared to reasonable alternatives before awarding the contract.

- Review whether the contract's provisions on matters such as performance measurement and supplier remuneration would be likely to ensure service delivery. It is important that the signed contract reflects the deal that was negotiated, is not ambiguous or has significant omissions. The contract should outline procedures for hand-over and termination of the contract. The contract should be capable of dealing with changes in the Ministry's requirements and should include appropriate sanctions and bonuses. Clear provisions for dealing with innovation while maintaining value for money should also be included. There are likely to be several contracts for example for site construction and facilities management, all contracts should be examined. Again legal advice may be required.

- Identify whether there are sources for any capital funds required to implement the project and for the ongoing payments payable under the contract. The auditor should confirm the ministry made one last check of the affordability of the contract, the availability of capital funds and the revenue funding needed to meet the payment requirements.
In coming to a decision about likely value for money offered by each option due weight should be attached to all relevant factors. Significant weight could be assigned to factors including safety, the bidders ability to strike a timely deal and the importance of a genuine partnership.

Value for money should be periodically assessed (against the PSC) once the contract is awarded; this gives better information about whether any clauses in the contract should be exercised.

Section 6 - Value for money during contract management

The purpose of this section is provide examples of audit steps to determine whether the ministry is adequately managing the contract

- Payment for performance. The auditor should examine whether the ministry has monitored the contractor's performance adequately and paid the contractor accordingly. Payments should relate to the adequacy of performance in achievement of project deliverables.

- Review the ministry's management of changes during the contract period to its requirements and to the provisions of the contract itself.

- Examine whether the ministry has succeeded in maintaining the allocation of risk laid down in the partnership agreement and has managed effectively those risks it retained.

- Examine whether there is adequate reporting of how the partnership deliverables were achieved. This should include annual report and corporate plans made public and tabled to the Legislature. The auditor should decide if this reporting is credible, accurate, fair and useful information to demonstrate the deliverables and appropriate use of public assets and funds. The measures used should be balanced to ensure accurate representation of the partnership's performance over time.

- Confirm that the monitoring plan is in place includes regularly reassessing value for money to give information on the exercise of contract clauses to avoid paying for unnecessary services. Parties in the accountability relationship should strive for continuous improvement in the partnership by critically reviewing results, taking corrective action and realign strategies. Part of the monitoring plan could include performance of compliance, attest, and value for money audits or strategic monitoring;

- Examine whether the ministry planned and managed effectively the exit from the contract on its expiry.
Appendix 7 - Possible Audit Objectives and Criteria by Life Cycle Step

The following appendix provides some specific audit objectives and criteria for assessing the efficiency and effectiveness of P3 management processes at various life cycle stages. The discussion, audit objectives and criteria presented were developed by KPMG for the Canadian Federal Government. (KPMG2, pp 16-30)

Strategic Analysis

Strategic analysis encompasses a formal, high level review and risk analysis of the services that the organization currently provides. The purpose is to determine whether the services are required to be performed by the organization or could be performed through a P3. This preliminary analysis will lead to the identification of the core business and areas for improvement. The following are potential audit objectives and criteria to consider during the strategic analysis step of a P3.

Audit Objective: To assess the appropriateness of the classification of current services (as a possibility for a P3).

Audit Criteria: Determine whether:

- the services have been appropriately defined and described;
- key stakeholders and clients have been consulted;
- there are any services that are unique and their relationship to other service areas;
- key competencies to be retained have been identified; and
- services have been assessed for process improvements.

Audit Objective: To assess the effectiveness of the risk assessment process.

Audit Criteria: Determine whether:

- strategic objectives, critical success factors in the delivery of the services, and significant business risks have been analyzed and communicated;
- risks have been identified and mitigating factors have been considered;
- the risk ranking of services has been completed; and
- a rationale has been provided and communicated for the type of service identified to be considered for a P3.
Analysis of P3 Opportunities

In determining the future of how the organization's services will be delivered opportunities identified above must be analyzed. Careful planning and analysis at this point will help set the stage for potential efficiency gains. By performing the up front planning and gaining a thorough knowledge of the variety of external services that are available in the marketplace, the pursuit of a P3 or the continuance of current services will be an informed decision. It is important to note that in some cases, a P3 may not be the beneficial choice because of risk, cost, etc. and those services should simply remain with the ministry. The following is a possible audit objective and some criteria to consider.

Audit Objective: To assess whether sufficient analysis of opportunities and options has been conducted by management.

Audit Criteria: Determine whether:

- P3 opportunities have been identified and communicated;
- a preliminary search of external provider capabilities have been conducted;
- infeasible options have been identified and eliminated;
- criteria to assess P3 opportunities have been evaluated;
- a comparison of the benefits/risks of P3 opportunities has been adequately assessed and a summary of the overall analysis with recommendations for the ministry has been prepared;
- a ranking and prioritization of the projects identified as P3 opportunities has been completed; and
- appropriate approvals from management have been attained to pursue the potential P3 opportunities.

Business Case Analysis

A business case analysis provides a thorough review of the service being considered for a P3. It supports planning and decision-making in evaluating a P3 opportunity and is designed to provide information on the likely financial and other business consequences of taking a certain action. A business case is a detailed analysis of factors, both positive and negative, qualitative and quantitative that will impact the opportunity. Its purpose is to determine the cost/benefit of a potential P3 opportunity and if it will provide increased value to the ministry and the province. The following are audit objectives and criteria to consider when reviewing a business case.
Audit Objective: To assess the adequacy of the project definition.

Audit Criteria: Determine whether:

- appropriate steps were taken to select the project authority; and
- the scope of the P3 project (including objectives, expectations, and performance measures) was adequately defined.

Audit Objective: To assess the existence and adequacy of the risk management plan.

Audit Criteria: Determine whether:

- appropriate steps were taken in developing the plan;
- the plan is clear and has been communicated to all parties; and
- the plan considers a forum for on-going risk assessment.

Audit Objective: To assess the effectiveness of the detailed risk assessment process.

Audit Criteria: Determine whether:

- a detailed review of the objectives of the service to be delivered through the P3 was conducted; and
- the significant risks were appropriately identified, analyzed, and ranked and mitigating factors were considered.

Audit Objective: To analyze the accuracy of the baseline costing exercise.

Audit Criteria: Determine whether:

- a baseline costing exercise was appropriately and accurately performed; and
- industry standards were reviewed for benchmarking purposes.

Audit Objective: To assess the effectiveness of the business case analysis process.

Audit Criteria: Determine whether:

- a detailed business case was performed that included factors such as the purpose of the business case, description of the services to be delivered through the P3, a public service comparator, human resource issues, assumptions and constraints, accountability requirements, analysis of options, and selection and recommendation of the best option;
- independent advice has been appropriately obtained; and
- adequate approval from management was granted.
Selection of a partner

Selection of a partner involves planning the selection process through to selecting the candidate. The purpose is to choose a partner that best meets the key criteria used such as, reliability, service-orientation, ability to comply with the accountability requirements and continuous improvement orientation. The following are some audit objectives and related criteria to consider when reviewing this step.

**Audit Objective:** To evaluate the effectiveness of the planning process for the Request for Proposal (RFP).

**Audit Criteria:** Determine whether:

- adequate project parameters for the P3 arrangement have been appropriately defined;
- appropriate approvals have been obtained from ministry executive, Treasury Board or higher;
- the proposal team selected included individuals who are independent to the process;
- the proposal team has discussed and documented preliminary evaluation criteria, impacts, and the cost/benefit analysis;
- sufficient consideration was invested in the type of selection process chosen; and
- a plan was established for the delivery option of the RFP.

**Audit Objective:** To evaluate the appropriateness of the defined RFP requirements.

**Audit Criteria:** Determine whether:

- appropriate steps have been taken to identify potential private sector partners capable of providing the service;
- the RFP includes specific criteria that are important to the ministry’s business needs; and
- appropriate technical and performance specifications have been developed for bidders to clearly demonstrate their abilities and experience.

**Audit Objective:** To evaluate the appropriateness of the evaluation criteria that have been identified.
Audit Criteria: Determine whether:

- the weighting and scoring system has been adequately developed and that the weightings are relevant to the important criteria outlined in the RFP;
- specific requirements for ranking the components of the RFP have been established and communicated to ensure consistency among the ranking personnel; and
- the higher review body has been involved and provided approval for the specifications and criteria included in the RFP.

Audit Objective: To assess the effectiveness of the development, release, and follow up of the RFP.

Audit Criteria: Determine whether:

- the RFP and completion instructions are clearly defined and straightforward, including the specification parameters;
- the logistical aspects of the RFP such as timelines, completion instructions, information sessions, deadlines, contractual terms, and methodology are complete;
- the RFP has been released in an appropriate manner to all identified vendors;
- a forum exists to provide clarification of information to potential candidates;
- a logical and independent process exists to track the receipt of the RFP responses;
- a high level review by the proposal team was established to eliminate unsuitable candidates and select potential candidates for oral presentations; and
- a process was established and communicated to ensure consistency in verifying proponents' references.

Audit Objective: To assess the fairness of the proposal evaluation process.

Audit Criteria: Determine whether:

- proposals were appropriately ranked according to the specifications outlined in the RFP;
- the proponent offering the best terms was selected through a fair evaluation;
- the recommended proponent was presented to the higher review body for approval; and
- the higher review body provided approval and endorsement of the selected candidate.
Implementation

The implementation of the transition plan is considered high risk. There is change occurring within the ministry at this stage, along with uncertainty often being felt at all levels. The purpose is to assist the transition team manage the migration to the P3 structure and handle the risk associated with this level of uncertainty and change. The following are some audit objectives and criteria to consider during P3 implementation.

Audit Objective: To analyze the effectiveness and efficiency of the transition process.

Audit Criteria: Determine whether:

- a "transition team" has been established to conduct the conversion and has effectively managed the process by dealing with important issues such as human resources (communication, logistics, downsizing), timing, and the new roles and responsibilities of the partners in the P3; and

- the current service delivery contract (if applicable) has been appropriately terminated and all outstanding issues have been resolved.

Audit Objective: To assess the completeness and fairness of the contract negotiation process.

Audit Criteria: Determine whether:

- an effective negotiation strategy including contract terms, service level agreements, and performance targets has been established and communicated and the process follows the strategy; and

- a valid contract exists, due diligence has been conducted, and the appropriate legal and higher body advice has been obtained prior to the final contract being signed.

Performance Monitoring and Evaluation

The contract or partnership performance monitoring and evaluation is crucial to managing a successful P3 relationship and the resulting transfer of risk and any sharing of accountability. The purpose is to establish guidelines and monitor performance of the P3 throughout the term of the agreement. This process will help identify and manage risks, assist with future decisions by increasing knowledge (lessons learned), and aid in reporting on results. The following are some possible audit objectives and criteria to consider when planning a review of a P3 during its operation.
Audit Objective: To evaluate the effectiveness of the monitoring process in place.

Audit Criteria: Determine whether:

- a sufficient post transition review on the operation of the P3 has been performed;
- a forum exists and has been communicated for clear complaint mechanisms;
- an accurate evaluation of achieved results against intended performance has been performed; and
- trend analysis of performance data has been developed.

Audit Objective: To evaluate the ongoing management of the P3.

Audit Criteria: Determine whether:

- appropriate arrangements for ongoing and regular monitoring and reporting of performance and actual results have been established;
- periodic reviews are conducted in a timely manner;
- a review of each partners' performance assessment has been conducted and documented;
- an evaluation of each partners' performance has been performed and documented;
- a review has been conducted of the P3's annual report, other financial information, and compliance with legal and contractual measures;
- there is effective monitoring in place to ensure the quality of service delivery at optimal cost and that quality assurance programs are in place;
- a forum exists for anomalies to be reported to ministry executive;
- effective remedial action is taken on the private sector partner if necessary;
- continuous improvement measures exist and are functioning well; and
- mechanisms are in place to reward high performance and penalize poor performance.
Completion and Continuation

The completion and continuation is the final stage of a P3. The purpose is to determine whether the partnership will continue with the private sector partner or whether a new arrangement will need to be established. The following are some audit objectives and criteria to consider at this stage of a P3.

Audit Objective: To assess the effectiveness of the level of services delivered compared against contract requirements.

Audit Criteria: Determine whether:

- outputs have been adequately evaluated against contract requirements;
- an assessment of the P3’s effectiveness in achieving the specified objectives has been appropriately conducted and communicated; and
- feedback was obtained from clients and stakeholders and used to improve the service.

Audit Objective: To determine the effectiveness of the succession process.

Audit Criteria: Determine whether:

- a sufficient strategic analysis was performed to determine the next steps;
- appropriate alternative approaches have been determined and documented; and
- the implementation of the chosen alternative was performed thoroughly, adequately and was well communicated.