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Measuring Compliance with Public Private Partnership Policy

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Public Private Partnerships are being utilised worldwide as a means to provide infrastructure assets and service delivery on behalf of the public sector. This paper aims to report on an empirical study that explores the extent of compliance with government policies for PPP projects and thus identify areas of concern that need to be addressed for future PPP projects. This paper undertakes a content analysis of four PPP project reports that have been produced by auditor generals. Six compliance criteria were identified as the benchmark against which four case studies were assessed. The findings reveal that none of the PPP projects had full compliance with PPP policy and specifically the area of public interest was completely ignored.

Field of Research: Public sector financial management, public sector governance, auditor general special reports.

1. Introduction

Public Private Partnerships (PPP) is not a new phenomenon having made its introduction in 1992 by the UK Conservative government under the title of the Private Finance Initiative (PFI). Since then, PPP have been adopted by governments worldwide. There is no one authoritative definition of PPP. For example, the Department of Treasury and Finance (Victoria) defines PPP as:

'…. a contract for a private party to deliver public infrastructure-based services' (DTF 2001, p. 3).

Whereas Broadbent and Laughlin (2003, p. 334) refer to PPP as:
'…an approach to delivering public services that involves the private sector, but one that provides for a more direct control relationship between the public and private sector than would be achieved by a simple market-based and arms-length purchase.'

It appears that PPP allow for much greater participation by the private sector for the delivery of services. Although there can be many variants of PPP, there are some common features which make them a unique public sector procurement model.This paper seeks to identify the extent to which PPP projects are compliant with PPP policy. Given the relatively large sums of

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money required for these projects and the time frame that future governments are 'locked' into, it is essential that an independent assessment is undertaken to ensure that policy objectives are met. This study will also inform public sector managers of the key criteria that must be addressed to ensure that they discharge their accountability function.

2. Literature Review: Public Private Partnerships

PPP are used worldwide and their use is increasing. PPP utilise private sector finance to design, construct, maintain and operate the infrastructure. They normally involve a capital component and an on-going service delivery component, which is paid for over the long term by a series of payments from the government similar to lease payments and/or in combination with a user-pays regime (Malone, 2005). Watson (2003) identified two main reasons for their increased use. The first is for government to reduce debt, and the second is to attain value for money (VFM) from these large projects. Lilley and De Giorgio (2004) identify VFM and the timely delivery of new infrastructure as the main reasons for their increased use.

Examples of infrastructure that has been developed using the PPP model include but are not limited to hospitals, roads, convention centres, schools, prisons and police stations. There are currently thirty-nine PPP contracted projects in Australia with an estimated value of $20 billion (Costa, 2005). This level of spending shows no signs of abating as the former Treasurer of Victoria, Mr. John Brumby, has noted: Over the next five years we will invest in excess a further $20 billion across the Government sector and the public authorities, plus Eastlink (Office of the Treasurer (Victoria), 2005).

There are a number of potential advantages in adopting the PPP policy for the provision of government services. Value for money appears to be the main rationale for the use of PPP. This would entail providing the infrastructure asset and any ancillary services at least cost compared to conventional government procurement. This is based on the assumption that quality standards are maintained as per the contract specifications. However, an investigation by Khadaroo (2008) of PFI bids for the development of schools in Northern Ireland found that VFM is subjective and that changes made to the assumptions or weightings given to quantitative or qualitative factors can shift the balance in favour of traditional procurement.

Risk transfer is another potential benefit. In essence, the party best able to manage risk at least cost should manage it. Some of the major categories of risk include design and construction, financial, operating, legislative and government policy risk. In a study by Broadbent, Gill and Laughlin (2008), 17 PFI UK health projects were investigated. Their findings suggest that 'accounting logic' dominates the decision-making processes because this provides justification for choosing the PFI model over traditional procurement. The authors emphasise the need for all aspects of risks to be monitored over the duration of the contracts. PPP allow for greater predictability of costs for the government and revenues for the private company since both of these are articulated in the contract. However, it can also be reasoned that, by locking itself into such a long-term agreement, the government faces the risk of not being able to re-negotiate the contract if and when circumstances and needs change over time. Finally, PPP may be politically attractive to government because it does not actually sell infrastructure assets to the private sector, which may be a more sensitive issue to an apprehensive electorate.

Disadvantages of PPP include that they can be quite complicated and complex arrangements and the associated process of preparing the contractual documentation and bidding process may lead to judging whether value for money has been achieved problematic. In addition, raising public sector finance is cheaper given that governments have the capacity to levy taxes to repay borrowings. If a private partner develops cash-flow problems and eventually is unable to fulfil its contractual obligations, this may have serious consequences for users of that particular service as well as for government generally. This situation occurred with the failure of the Latrobe Regional Hospital in Victoria. Rather than renegotiating this PPP contract, the State Government of Victoria decided to step in and take over the operations of the hospital due to the financial problems experienced by the private operator (English 2004).

There is a real need to evaluate PPP projects comprehensively to ensure that the expected benefits from adopting this policy are realised. This deficiency was highlighted by an OECD report that concluded that there was a lack of systematic evaluations of the results from PPP and it was inconclusive to judge whether the potential savings generated from adopted PPP were maintained in the long run (OECD 2008). Thus, how governments cost and account for PPP is central for determining the effectiveness of this policy.

Moving towards a greater emphasis on the need for audits to investigate such complex New Public Management (NPM) practices such as PPP, Lapsley (2008) and Power (1997) suggests that more and more aspects of the NPM are being audited. There is already a heavy emphasis on VFM audits and audits can go further in shaping the behaviour of public sector managers. This is further evidence of the need to investigate how auditors audit PPP and whether managers will seek to make their management practices and decisions auditable.

3. Methodology And Research Design

A measure of probity and accountability with respect to PPP projects can be ascertained by undertaking a review of auditor general reports that have investigated this procurement method. This paper undertakes a content analysis of four PPP project reports that have been produced by auditor generals. The Partnerships Victoria (PV) policy guidelines are used as the benchmark for developing a disclosure index to quantify the level of compliance with policy.

A web-site analysis of the office of the auditor general in each of the six states and two territories in Australia identified four special auditor reports that related specifically to PPP projects. The auditor general reports were selected on the basis that that would provide an impartial assessment of the PPP projects investigated. The four cases spanned three states Victoria, NSW and Tasmania and looked at three distinct infrastructure assets. These were the:

- Southern Cross Railway Station (Victoria),
- Melbourne Convention Centre Development (Victoria),
- New Schools Privately Financed Project (New South Wales) and
- Risdon Prison (Tasmania).

Each of the cases represented in the special auditor reports are assessed against the six principles identified in the PV guidance material (2006) to ascertain to what extent each of the four projects adhered to these principles. PV principles were used as the benchmark given that the State of Victoria has the most comprehensive selection of guidance material on PPP in Australia and some states that are still developing policies in this area are adopting the Victorian model as their starting point. The State of Victoria began issuing policy documents on PPP in 2000, and has refined and updated the material where needed. In addition, an examination of the PPP forum web-site demonstrates that Victoria has the most PPP projects currently completed in Australia. Currently, Victoria has seventeen projects in existence worth approximately $5.5 billion. Thus, based on the volume of PPP projects undertaken (17 of the 39 PPP projects in Australia equates to 43%), the value in dollar terms and experience the State Government of Victoria has in this area it was ascertained that using the PV guidelines as the benchmark for compliance was deemed appropriate.

A compliance score was developed using a technique developed by Herawaty and Hoque (2007). In that study, the authors investigated the disclosure practices of Australian government departments by undertaking a content analysis of annual reports. A disclosure score sheet was developed by scoring one point for disclosing an item and zero for not disclosing an item. From this a disclosure index (DI) was calculated by dividing the total number of items disclosed with the total number of items that could have applied to the department. For this investigation an analysis of the PV guidance material revealed that there were six key criteria which would determine the success or otherwise of a PPP project. The six criteria were:

- Value-for-money,
- Public interest,

- Performance management,
- Optimal risk allocation,
- Project governance and,
- Contract management.

Thus, one point was allocated for a positive comment pertaining to those particular criteria, a zero for no comment and a negative one for a negative comment. From this, a tally is measured where the higher the total compliance score (TCS), the more favourable the outcome of the PPP project in terms of compliance with PV policy.

4. Findings

Case 1 – Southern Cross Railway Station (VIC)

The Southern Cross Railway Station redevelopment was formerly known as Spencer Street station in Melbourne's central business district. The objective of the project was to develop a world class inter-modal transport and railway station for Victoria. It included the transport interchange redevelopment and a commercial redevelopment that included a retail precinct, car parking and offices. In July 2002, the Southern Cross Station Authority (SCSA) entered into an agreement with Civic Nexus Pty Ltd (the consortium) to design, build and manage the operations of the station for a period of thirty years. The net cost to the government was $309 million (NPV).

Construction progress was slow due in part because of the requirement that the construction was not to impede on the current timetable of rail services to commuters. By late 2004 the developer, Leighton Contractors Pty.Ltd. had forecast a loss on the project of $122.6 million, and commenced making compensation claims against the State of Victoria. An agreement was finally reached where the State settled for a sum of $32.25 million for modifications, additional works and to settle all residual claims.

Criteria	**Score**
1. Value-for–money (business case)	1
2. Public interest	-
3. Performance management (KPIs)	1
4. Optimal risk allocation	5
5. Project governance	-
6. Contract management	1
Total Compliance Score (TCS)	**8**

Case 2 - Melbourne Convention Centre (VIC)

The Melbourne Convention Centre (MCV) development will incorporate a plenary hall that can accommodate 5000 delegates, a ballroom, 32 meeting rooms and a foyer for 8400 guests. It has a total value of $367 million and is expected to open in 2009. A consortium led by the Plenary Group has been awarded the contract to build the facility and is responsible for the up keep of the centre and operation of ancillary services for 25 years.

Criteria	**Score**
1. Value-for–money (business case)	1
2. Public interest	-
3. Performance management (KPIs)	1
4. Optimal risk allocation	1
5. Project governance	5
6. Contract management	1
Total Compliance Score (TCS)	**9**

Case 3 - New Schools Private Finance Project (PFP) (NSW)

The NSW Department of Education and Training decided to adopt a PFP for the design and construction of nine new schools for a total cost of $137 million. School facilities such as fixtures and fittings, equipment, furniture, playgrounds and gardens were also included in the contract. In addition, the contract included providing cleaning, security, utility and maintenance and repair services for each school. The schools would then be handed back to the State after a period of thirty years.

Criteria	**Score**
1. Value-for–money (business case)	1
2. Public interest	2
3. Performance management (KPIs)	1
4. Optimal risk allocation	1
5. Project governance	1
6. Contract management	-2
Total Compliance Score (TCS)	**4**

Case 4 - Risdon Prison (TAS)

The re-development of Risdon prison in 2006 was at a cost of $90 million. The building that it is replacing was constructed in the late 1950s and was pre-dominantly a maximum security prison built to provide a secure facility rather than providing a range of services to modify prisoner behaviour. The main criticisms from the auditor general relate to inadequate risk analysis and the construction of a capital budget that was excessively optimistic in relation to its cost.

Criteria	**Score**
1. Value-for–money (business case)	-1
2. Public interest	-
3. Performance management (KPIs)	-
4. Optimal risk allocation	-2
5. Project governance	-
6. Contract management	-
Total Compliance Score (TCS)	**-3**

The findings reveal that case 2 had the highest TCS followed by case 1 case 3 and finally case 4.

Case 1 had a high score for the manner in which the risks between the State and the partner were allocated. However, no score was allocated to public interest or project governance. Case 2 had a high score for project governance however, like case one no score was given to public interest. Case 3 had scores across the six criteria, however, achieved a negative 2 for contract management. Finally, case 4 gained negative scores for value-for-money and optimal risk allocation. Some possible explanations for these results can be attributed to the fact that the PV guidelines were used as the benchmark to confirm if criteria were being adhered to. Thus, it would be expected that PPP projects in Victoria would receive higher scores. At the time of the construction of the Risdon Prison, the Tasmanian Government had not yet developed any PPP guidelines and hence, this could explain the low scores for this project.

Given that there were no consistencies in scores across the four cases, it can be surmised that each PPP project should be analysed on a case-by-case approach rather than making general statements regarding PPP per se. It is also important to note that the practice of PPP is evolving and that it would be expected that over time the TCS would increase as governments and their partners become experienced with the contractual and operational characteristics of PPP. Three of the four cases had no score for the *public interest* criteria. Public interest criteria includes items such as public access, consumer rights, health and safety, privacy and accountability and transparency. Yet the PV policy states that the government is committed to ensuring that each partnership project is assessed against the public interest.

5. Conclusion

Of the thirty-nine projects in Australia that have been contracted using PPP as the mechanism for the design, finance, construction and service delivery of the infrastructure asset, thus far, there have been four auditor general reports specifically assessing the effectiveness of the PPP framework. This study reports on the published reports of Auditor-Generals dealing exclusively on a select number PPP projects and therefore, does not include all completed PPP projects in Australia. The highest compliance with the PV policy document occurred in Cases one and two; both being based in the State of Victoria. The Victorian State Government has been the most aggressive in promoting the benefits of PPP and was also the first state to produce a comprehensive set of PPP guidelines that other states have referred to. This is one explanation for the highest TCS.

The findings reveal a high level of compliance with key criteria such as the development of the business case, risk identification/allocation and management of the project, however, less disclosure on public interest criteria. This criteria may have been assessed internally by treasury officials as part of the overall assessment of whether to use the PPP model or traditional procurement, however, no measurement of the adequacy of this assessment is possible because only the auditor of case three made mention of this criterion. One possible limitation of this study was that auditor general reports, by their very nature, tend to highlight problem areas rather than focussing on actions that were completed appropriately. Therefore, it could be presumed that only negative discussion of the PPP projects would be highlighted. However, a thorough reading of the special auditor reports highlighted that both processes that were completed with the PPP guidelines as well as areas in need of improvement were discussed. Thus, from this perspective, it was a balanced investigation.

Which PPP projects ought to be subjected to an audit, the timing and the extent of the audit is beyond the scope of the current investigation, however, this leaves open the opportunity for further research in this area considering that all State governments and the Federal Government are keen to continue to use this model for infrastructure development. The findings in this report add to the body of knowledge on the efficacy of utilising the PPP framework to develop infrastructure assets and related service delivery.

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