

Infrastructure—Alberta Schools Alternative Procurement Follow-up

SUMMARY

In 2010 we audited systems the Department of Infrastructure¹ used in applying the P3 (private-public partnership) framework to the Alberta Schools Alternative Procurement project. The P3 framework identifies an alternative approach to building and paying for public facilities like schools and hospitals. Our objective was to determine whether the department had effective systems to:

- assess the potential value for money of the ASAP project
- ensure procurement activities were fair and transparent

We made two recommendations in April 2010.² This year, we assessed the department's progress in implementing our recommendations to:

- improve the processes it uses to challenge and support maintenance costs and risk valuations
- publish value for money reports upon entering into P3 agreements

The department implemented our recommendations by using its historical data on school costs to support its assumptions on maintenance costs and to validate its risk valuation. The department also published value for money reports for its ASAP P3 projects.

Why this is important to Albertans

Albertans need to know if the government's processes to deliver P3 projects are open and transparent, and can demonstrate that value for money will be achieved.

AUDIT OBJECTIVE AND SCOPE

Our audit objective was to determine if the department implemented the two recommendations from our 2010 report.

Our audit was not an assessment of whether value for money was achieved, but rather an audit of the systems management implemented in response to our recommendations. The assessment of whether value for money will be achieved is the responsibility of the department's management.

We conducted our field work from June 2013 to November 2013 and focused on the department's actions since our April 2010 report. We substantially completed our audit on December 5, 2013. Our audit was conducted in accordance with the *Auditor General Act* and the Canadian Institute of Chartered Accountants' standards for assurance engagements.

¹ In 2006 the Department of Infrastructure developed frameworks for assessing and procuring P3 projects. In 2011 the Department of Treasury Board and Finance replaced these frameworks with the *Alberta Public-Private Partnership Framework and Guideline*. We made our original recommendations to both departments. The Department of Infrastructure is currently responsible for the framework and for overseeing P3 projects. Therefore, our follow-up audit focused on steps it has taken to implement our recommendations.

² *Report of the Auditor General of Alberta—April 2010*, starting at page 13.

BACKGROUND

Traditional procurement

In the traditional procurement model, approval and funding for building a new school follows capital planning processes of the school jurisdictions and the provincial government. The Department of Treasury Board and Finance approves the use of public funds to build schools. Each school jurisdiction manages the design and construction, as well as routine and major maintenance of its schools.

School jurisdictions enter into contracts with third parties for design, construction and maintenance activities over the lifetime of schools. The Department of Education provides annual maintenance funding and school jurisdictions allocate these funds to individual schools. Routine maintenance may be provided by school jurisdiction staff or by contractors.

Public–private partnership procurement

A P3 is a procurement approach in which a private contractor provides some or all of the financing for the project; designs and builds the project; operates and maintains the project; and receives payments from government over an extended period of time, subject to deductions for failing to meet contractually defined performance standards.³

The P3 framework provides guidance for assessing potential P3 projects and delivering them in Alberta. It defines terms that have specific meaning in financial analysis and in the evaluation of P3 proposals. Value for money is an assessment of the quantitative cost of a project in relation to the qualitative benefits expected to be received. A procurement option that provides the same benefits but at a lower cost than another alternative provides greater value for money.

The department assesses a P3 project's potential value for money by comparing the net present value of the contractors' bids received to its own estimates of the project's costs. Called the public sector comparator, this number is an estimate of the risk-adjusted cost of a project financed, owned and implemented by the government through a traditional procurement model. The PSC serves as a benchmark against which to evaluate the procurement alternatives. The department develops a shadow bid by modeling the project as if it were delivered through P3 procurement. In a business case, the department compares its shadow bid to the public sector comparator to decide whether the project should proceed as a P3.

Alberta Schools Alternative Procurement

In June 2007 the Minister of Education announced phase one of the Alberta Schools Alternative Procurement project. Called ASAP 1, its goal was to build 18 schools using a design-build-finance-maintain procurement approach. Unlike traditional procurement, the DBFM approach:

- uses standard core modular school designs to reduce design costs
- requires contractors to design a structure that could be built to required standards
- bundles more schools into one contract to achieve economies of scale
- requires contractors to finance the construction of the schools
- commits public funds to pay contractors to carry out maintenance and renewal activities for these schools
- makes contractors responsible for ongoing maintenance and renewal of the structure

The 18 schools were completed one month earlier than the contracted completion date of June 30, 2010. Since then, the department has used the P3 model to build more schools. Phase two,

³ Alberta Public–Private Partnership Framework and Guideline, page 9.

ASAP 2,⁴ has been completed: 10 new schools opened in 2012. ASAP 3 is under construction and 12 schools are expected to open in the 2014–2015 school year. The department has obtained the Department of Treasury Board and Finance’s approval for phase four to provide 19 additional schools.

FINDINGS

Challenging and supporting assumptions—implemented

Background

In 2010 we recommended that the department improve its processes, including performing a sensitivity analysis, to challenge and support maintenance costs and risk valuations.⁵ The P3 framework requires management to document its assumptions for the PSC and shadow bid and, where possible, to base PSC costs on actual costs from prior projects. It also suggests a sensitivity analysis to show the effects of different assumptions on the value for money of the procurement options.

However, in 2010 we found that the department:

- did not retain evidence to support maintenance costs
- estimated maintenance costs using government owned office space costs rather than schools
- developed risk valuations based on anecdotal evidence rather than actual costs from prior school construction projects
- did not include a sensitivity analysis or provide an explanation why a sensitivity analysis was not included in the business case

Our audit findings

For ASAPs 2 and 3, the department retained supporting information for maintenance costs and based its risk valuation on actual costs from prior school construction projects. It also included sensitivity analyses in its business cases.

The department based its maintenance costs for ASAP 2 and 3 on school facilities. It engaged a cost advisor with experience in cost–benefit analyses of many Alberta schools. The cost advisor determined the average maintenance costs of these school facilities. The department then used this average cost in its public sector comparator and applied a labour efficiency rate on the maintenance costs for its shadow bid.

We obtained consolidated information from the Department of Education for Edmonton and Calgary Catholic and public schools, and calculated the maintenance costs per square metre. The maintenance costs the department used in ASAPs 2 and 3 were comparable to the information from the Department of Education.

For risk valuation, the department conducted workshops with representatives from several ministries and external consultants to identify risks. Through the workshops, the department identified various risks. It quantified the risks that were material to the project and different between the delivery alternatives. Participants in the workshop provided input based on their technical expertise, professional experience and judgement, and reached consensus on the probability and impact of risks based on worst case, typical case and best case scenarios.

⁴ The project procured an additional four schools traditionally.

⁵ *Report of the Auditor General of Alberta—April 2010*, no. 1, page 22.

To quantify the cost of these risks, the department multiplied the project base cost by a value assigned to the probability and impact of each risk. The department demonstrated that the significant estimated risk costs were comparable to actual costs from prior school construction projects.

The department conducted sensitivity analyses to assess what effect the level of provincial financial contribution and the interest rate spread would have on the project's value for money. The department determined the amount of provincial contribution based on industry feedback and contribution levels in previous projects. Interest rate spreads were based on current financial market conditions. It established a range for the inputs and assessed how different values of the inputs would impact the potential value for money.

Transparency—implemented

Background

In 2010 we recommended that the department follow its own guidance to publish a value for money report upon entering into a P3 agreement.⁶ To ensure the process is timely and transparent, a report should be prepared within six months of entering into a P3 agreement to inform Albertans about how value for money will be achieved. We found that a report was not published as required by the department's P3 framework.

Our audit findings

The department published the value for money reports according to the requirements of its P3 framework. The department published the ASAP 1 value for money report after our original audit and more than a year after the required disclosure deadline. However, it published the reports for ASAPs 2 and 3 within six months of signing the P3 agreements.

The reports describe, as required, the P3 project goals, outcomes and procurement process, and explain the value for money assessment process, including quantitative and qualitative measures of value. They also show how major project risks were allocated between the government and the P3 contractor. The reports also describe the P3 selection process, summarize key terms of the project agreement and indicate the amount of money the government estimates it will potentially save through the P3 approach.

⁶ *Report of the Auditor General of Alberta—April 2010*, no. 2, page 24.