

PUBLIC PRIVATE PARTNERSHIPS IN AUSTRALIA: AN OVERVIEW OF THEIR NATURE, PURPOSE, INCIDENCE AND OVERSIGHT

LINDA M ENGLISH*

I INTRODUCTION

For centuries, governments have used private contractors to provide a wide variety of public services.¹ More recently, partnerships between governments and private contractors have become a feature of the ‘new public management’ (‘NPM’) reform movement that has radically altered public administration processes across countries in the Organisation of Economic Cooperation and Development (‘OECD’) in its attempts to increase the economy, efficiency and effectiveness of the public sector.² The term ‘public private partnership(s)’ (‘PPP(s)’), while universally used, has different contemporary meanings and manifestations.³ Differences in PPP models stem from situationally-specific contextual factors that affect their outworking in different jurisdictions over time and, in turn, their nature, purpose, characteristics, implementation and oversight.

This introductory paper on PPPs has several purposes. First, it examines various partnership relationships recently used by Australian governments to deliver infrastructure-based services, and distinguishes between different PPP models that have evolved in the local context. Second, it considers the nature of PPPs and how, theoretically, their primary purpose is achieved in the pre-contractual stage. Third, it provides empirical evidence of the number, category and cost to governments of PPPs contracted in Australia at December 2005.

* Senior Lecturer, Discipline of Accounting, Faculty of Economics and Business, University of Sydney. This article was written with funding from the Australian Research Council for research into post-performance evaluation of public private partnerships (‘PPPs’).

1 Carsten Greve and Graeme Hodge, ‘Introduction’ in Graeme Hodge and Carsten Greve (eds), *The Challenges of Public-Private Partnerships: Learning from International Experience* (2005) 1, 1.

2 Olov Olson, James Guthrie, and Christopher Humphrey (eds), *Global Warning! Debating International Developments in New Public Financial Management* (1998); Christopher Pollitt and Geert Bouckaert, *Public Management Reform: A Comparative Analysis* (2000); Linda M English and Matthew Skellern, ‘Public-Private Partnerships and Public Sector Management Reform: A Comparative Perspective’ (2005) 1 *International Journal of Public Policy* 1; Linda M English, James Guthrie and Lee D Parker, ‘Recent Public Sector Financial Management Change in Australia: Implementing the Market Model’ in James Guthrie et al (eds), *International Public Financial Management Reform: Progress, Contradictions and Challenges* (2005) 23; Greve and Hodge, above n 1.

3 Pollitt and Bouckaert, above n 2, 6 ff; English and Skellern, above n 2, 4 ff.

Fourth, the paper presents the results of a recent empirical study into all stand-alone performance audits of PPPs undertaken by Australian auditors-general in the period between 1994 and 2006.⁴

II DISTINGUISHING BETWEEN PPPs AND OTHER OUTSOURCING ARRANGEMENTS

Economy, efficiency and effectiveness of service delivery, or value for money ('VFM') in service provision, have been major drivers of NPM reform. Infrastructure-based outsourcing, privatisation and PPPs can be distinguished on the basis of asset ownership and the extent of the state's control over the quantity, quality and cost of services.

In an outsourcing arrangement such as a detention centre, the state owns the infrastructure and the private contractor provides associated services which are paid for by the state. What distinguishes outsourcing is the public ownership of the infrastructure asset, and the public responsibility for its construction and design, and funding. Also, outsourcing attracts less negative public attention than PPPs or privatisation, but requires that governments have the ability to fund infrastructure construction in a political climate that views public borrowings negatively. To avoid the negative impact on public borrowings, privatisation or PPPs may be used.

Privatisation (such as the sale of the Commonwealth Bank or of Telstra) involves the sale of the asset and of the right to produce and sell associated services. The state's ability to influence service quality and cost to consumers is more circumspect. It relies on law and regulation to manipulate social outcomes from privatised corporations. However, with little left to sell, privatisation, which was used to raise funds to eliminate public debt in the 1990s, has largely served its purpose, and is unpopular with the electorate.

PPP arrangements are distinguished by a long-term relationship between the state and a private contractor for the construction, maintenance and operation of infrastructure assets and procurement of related services. In PPPs, the private contractor owns the infrastructure for the term of the contract and provides contracted services which are paid either directly by government or by consumers. Typically, the asset reverts to the state at the end of the agreement. PPPs provide governments with the opportunity to bring on stream new infrastructure projects earlier than might otherwise be possible, ostensibly without the associated ballooning of public debt. They also enable governments to reap the benefits of VFM, derived from the use of private money to promote private risk taking and inventiveness.

These service delivery solutions are based on the premise that private provision offers superior savings to consumers and governments. All involve the need to compare the costs and efficiencies between existing (public) supply and

4 Linda M English, 'Investigating Performance Auditing of Australian Public Private Partnerships' (2006) (Working Paper, Discipline of Accounting, Faculty of Economics and Business, University of Sydney) (unpublished).

supply involving the private sector as contractor/purchaser/partner. In theory, such decisions are made on the basis of appropriate net present cost, or similar mathematically-based calculations, using established and credible methodologies. However, while the methodologies may be relatively straightforward, there have been numerous criticisms of their application in the ‘in-house’ versus ‘outsource’ debate.⁵ Choice of service arrangement is largely explained by the nature of services provided (which determines demand and, hence, the source of the revenue stream), political ideology and necessity.

III PPP TRENDS IN AUSTRALIA

PPP use in Australia can be broadly separated into two periods: pre-2000 and post-2000. The establishment of Partnerships Victoria within the Victorian Department of Treasury and Finance in 2000 marked a watershed in PPP implementation and development. This reform resulted in a number of significant outcomes. First, the term ‘public private partnership’ was formally adopted to cover the range of PPP models that had previously been separately identified by acronyms.⁶ Second, the delivery of core state-subsidised hospital and corrective services was removed from private sector provision in PPP arrangements.⁷ Third, Victoria began developing a suite of comprehensive PPP-specific steering mechanisms. These mechanisms were based on the United Kingdom’s (‘UK’) private finance initiative (‘PFI’) model⁸ which established a set of procedures to govern the pre-contractual decision making stage leading to the signing of a PPP contract, and monitoring and oversight in the construction and operating stages.⁹ PPP policies in other Australian jurisdictions are based on the Victorian policies. In 2005, the federal and all State governments formally agreed to harmonise their approach to PPP development and implementation.¹⁰

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- 5 David J Johnstone and Michael J R Gaffikin, ‘Review of the Asset Valuation Guidelines of the Steering Committee on National Performance Monitoring of GTEs’ (1996) 6(1) *Australian Accounting Review* 50; Tyrone M Carlin, ‘Measurement Challenges and Consequences in the Australian Public Sector’ (2000) 10(2) *Australian Accounting Review* 63.
 - 6 Prior to 2000, the two most common PPP models were the ‘build, own, operate’ (‘BOO’) model and the ‘build, own, operate, transfer’ (‘BOOT’) model. In this period, Australian PPPs included delivery by private consortia of core hospital and corrective services. Loan Council rules, which changed in 1996, were influential in PPP packaging in the period from 1980 to 1996: see Linda M English and James Guthrie, ‘Driving Privately Financed Projects in Australia: What Makes Them Tick?’ (2003) 16 *Accounting, Auditing and Accountability Journal* 493.
 - 7 In the 1990s, Australia outsourced the delivery of core medical and correctional services management in PPP hospitals and prisons. In the United Kingdom (‘UK’), by contrast, health services have never been privatised. However, correctional services have always been contracted out in private finance initiative (‘PFI’) prisons.
 - 8 Department of Treasury and Finance, Victoria, *Partnerships Victoria* (2000) Partnerships Victoria 1 <[http://www.partnerships.vic.gov.au/CA25708500035EB6/WebObj/Policy/\\$File/Policy.pdf](http://www.partnerships.vic.gov.au/CA25708500035EB6/WebObj/Policy/$File/Policy.pdf)> at 12 October 2006.
 - 9 Linda M English, ‘Using Public-Private Partnerships to Achieve Value for Money in the Delivery of Health Care in Australia’ (2005) 1(1/2) *International Journal of Public Policy* 91.
 - 10 Duncan Hughes with Mark Ludlow and Lisa Allen, ‘PPP Reforms to Allay Concerns’, *Australian Financial Review* (Sydney), 9 June 2005, 3.

Common to all PPPs is an arrangement where a private consortium contracts with a public sector agency to finance, design and construct (or refurbish) a facility under a time and cost-specific contract. Following construction, which is undertaken and financed by the consortium, services are provided under a long-term contract. A revenue stream is used to repay debt, fund operations, deliver contracted services and provide a return to investors. Payments are not made until the asset is commissioned and operational.

The Victorian Government recognises two distinct PPP models that are characterised by different payment scenarios based on demand for services.¹¹ The chief differences between the two PPP categories are the source of the revenue stream and the nature of government guarantees.

The first PPP model has been in use since 2000 and closely resembles the UK's PFI model (also known as 'social' privately funded projects ('PFPs') in New South Wales ('NSW')). Under this model, core public services (health, correctional, educational) are delivered by government agencies and associated ancillary services (maintenance, fittings, furniture, equipment, grounds etc) by the consortium. In these arrangements, the government assumes demand risk, guarantees a minimum revenue stream, and pays directly for service provision. Deductions occur if the consortium does not meet specified performance standards. The service elements of contracts are usually subject to recontracting at five-year intervals, providing governments and consortia with the opportunity to finetune the service component to ensure that it meets current market conditions in terms of cost-effectiveness.

Characteristic of the second PPP model (which includes toll roads and utilities) is the transfer of revenue risk to the consortium. In these arrangements, there is no direct government revenue guarantee. In the case of toll roads, for instance, the revenue stream is received directly from motorists. These projects are known as 'economic' PFPs in NSW because the provider theoretically faces market risks, such as traffic and revenue risks. However, also in these arrangements, governments effectively underwrite an agreed real rate of return on investment through lengthy terms, toll escalation arrangements, and undertakings to minimise existing and future competitive public transport options, for example, through 'traffic calming' measures. This ensures that the tolls cover the cost of the asset, its financing, maintenance and the consortium's operating costs.¹² A variety of hybrid models are used to capture different demand and risk scenarios, and project types.

11 Department of Treasury and Finance, Victoria, *Practitioners' Guide* (2001) Partnerships Victoria 5 <[http://www.partnerships.vic.gov.au/CA25708500035EB6/WebObj/PVGuidanceMaterial_PracGuide/\\$File/PVGuidanceMaterial_PracGuide.pdf](http://www.partnerships.vic.gov.au/CA25708500035EB6/WebObj/PVGuidanceMaterial_PracGuide/$File/PVGuidanceMaterial_PracGuide.pdf)> at 15 October 2006.

12 Government underwriting of consortia profits explains why investing in PPPs is viewed favourably by capital markets in Australia.

IV THE NATURE AND PURPOSE OF PPPs

Initially, there was debate about the nature and purpose of PPPs.¹³ Was their primary purpose to avoid public debt, or to achieve VFM for the state? Since 2000, as articulated in PPP steering mechanisms, the official rationale underlying their use has been that they deliver VFM; ostensibly, their accounting treatment is not important.

VFM is generally defined as getting ‘the best possible outcome at the lowest possible price’.¹⁴ At its most theoretical level, VFM for government arises from the optimal allocation of risks between the state and consortia. It is now recognised that VFM is not wholly a financial concept but can also include non-financial benefits such as innovation and timely construction.

The most compelling source of VFM arises from the bundling of services. This bundling provides consortia with an incentive to deliver services, including the infrastructure asset, more efficiently than the state can because private money is at risk. The obligations to maintain and transfer the asset to the state at the end of the term, and to provide asset-based services over the life of the contract, are additional incentives to minimise whole of life costs. Consequently, the economy and efficiency of service provision is maximised through effective and efficient design and construction and the commissioning of assets on budget and on time, or before the due date. These risks, which are transferred to the private sector, would otherwise remain with the public sector. Thus, optimal outcomes for governments and consortia are achieved through risk transfer, which accounts for and justifies the difference in cost between public and private finance.¹⁵ As noted below, confirming the achievement of VFM savings in the operating stage can be problematic.¹⁶

IV IMPLEMENTING VFM

Risk transfer is the government’s key justification for PPPs because without substantial risk taking by the private sector they would not be worth undertaking. The importance of risk transfer is reflected in the evaluations of VFM that take place in the pre-contractual stage. Before a PPP scheme can be approved, it must be demonstrated that the deal will save money when compared to the publicly financed alternative.

13 Jane Broadbent and Richard Laughlin, ‘The Private Finance Initiative: Clarification of a Future Research Agenda’ (1999) 15 *Financial Accountability and Management* 95.

14 New South Wales Treasury, *Submission to the Inquiry into Public Private Partnerships* (15 November 2005) 13.

15 Allyson Pollock, David Price and Stewart Player, *Public Risk for Private Gain? The Public Audit Implications of Risk Transfer and Private Finance* (2004) Unison <http://www.health.ed.ac.uk/CIPHP/publications/unison_2004_public_risk_for_private_gain_the_public_audit_im.pdf> at 15 October 2006.

16 *Ibid*; English, ‘Investigating Performance Auditing’, above n 4; Pam Edwards et al, *Evaluating the Operation of PFI in Roads and Hospitals* (Research Report No 84, Association of Chartered Certified Accountants, 2004) <<http://image.guardian.co.uk/sys-files/Society/documents/2004/11/24/PFI.pdf>> at 15 October 2006.

The Public Sector Comparator ('PSC') is the technical construct¹⁷ developed to test whether privately financed arrangements provide superior VFM to traditional bundled procurement methods. A PSC calculates the net present cost of the hypothetical¹⁸ public provision of the infrastructure and the services. It is expressed as a single net present cost amount against which bids are compared and involves four elements:

- The raw PSC that determines the cost of the public procurement option, including estimated net capital and operating costs over project life.
- The cost of transferable risks that are often a key determinant of VFM and are frequently updated to allow for variations in risk allocations as negotiations proceed prior to contract signing.
- The financial and non-financial cost of risk retained by the government, including that of performance failure.
- A competitive neutrality adjustment, essentially involving the application of the National Competition Policy in order to remove any net competitive advantage of the public option (such as non-tax status) relative to the private option.

The PSC has been criticised on numerous grounds, including that it is sensitive to a number of assumptions necessary for its calculation and that the discount rate methodology is faulty because the real issue is uncertainty and not risk, which renders calculations problematic. Also, the length of contracts (sometimes up to 40 years) may render financial calculations and assumptions about costs, discount rates and risk allocation incomplete, resulting in inappropriate bases on which to draw conclusions about the viability of proceeding with the PPP option. Moreover, some argue that more emphasis needs to be given to non-financial elements in a longer-term evaluation.¹⁹ Others have also noted that the PSC may not take into account indirect government costs, such as ongoing monitoring costs, and, in the case of Sydney's Cross City Tunnel, the costs of associated road works.²⁰

The centrality of risk allocation and anticipated VFM to justify taking the PPP service delivery option, together with reservations about VFM calculations, suggest that verifying their achievement is a likely focus of post-contractual oversight arrangements. Changes in risk transfer and risk premiums favourable to consortia crystallised in the operating stage should be compensated by reductions

17 The Public Sector Comparator ('PSC') is based on decision models used in the private sector to determine whether or not a company should invest in infrastructure-based projects.

18 'Hypothetical' because many PPP projects would not be brought to fruition if they were not 'PPPable'.

19 Darrin Grimsey and Mervyn K Lewis, 'Are Public Private Partnerships Value for Money? Evaluating Alternative Approaches and Comparing Academic and Practitioner Views' (2005) 29 *Accounting Forum* 345.

20 See, eg, Olov Olson, Christopher Humphrey and James Guthrie, 'Caught in the Evaluatory Trap: The Dilemma of Public Services under NPFM' (2001) 10 *European Accounting Review* 505.

in the stream of payments to private consortia if VFM is to be achieved as anticipated.²¹

VI THE INCIDENCE OF PPPs IN AUSTRALIA

Australian PPPs have been used for delivering projects such as major toll roads,²² hospitals,²³ prisons,²⁴ schools,²⁵ utilities²⁶ and sporting facilities.²⁷ There is no one resource that provides an accurate and current list of these projects. Table 1, which is drawn from two Australian Council for Infrastructure Development databases²⁸ and from internet searches, provides a summary of the number and value of PPP projects in 11 project categories entered into in the period between 1980 and 2005.²⁹ Whilst Table 1 aims to capture the total PPP cost to governments on a net present cost basis,³⁰ it, nonetheless, due to incomplete disclosures, is based on a mixture of costs that have been determined on different bases.³¹ The end result is a table containing 127 projects worth \$35 669 million.

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- 21 For example, when a PPP project moves into the operating stage risk typically reduces, resulting in lower interest rates charged to the consortium after any refinancing. In such a case, value for money will not be achieved unless the state can share in the gains from refinancing.
- 22 For example, the Sydney Harbour Tunnel (NSW) and the Melbourne CityLink (Victoria).
- 23 For example, the Hawkesbury Hospital (NSW), Mildura Base Hospital (Victoria) and Joondalup Health Campus (WA).
- 24 For example, the Borallon Correctional Centre (Queensland), the Junee Correctional Centre (NSW) and Acacia Prison (WA).
- 25 For example, the two new schools projects in NSW.
- 26 For example, the Macarthur Water Treatment Plant (NSW), the South-West Queensland Gas Pipeline and the Challicum Hills Wind Farm (Victoria).
- 27 For example, Stadium Australia (now Telstra Stadium) (NSW) and Docklands Stadium (now Telstra Dome) (Victoria).
- 28 Australian Council for Infrastructure Development, *Delivering for Australia: A Review of BOOs, BOOTs, Privatisations and Public-Private Partnerships: 1988 to 2004* (2005) <www.auscid.org.au/home2/downloadproc.php?id=125> at 15 October 2006; Australian Council for Infrastructure Development, *Delivering for Australia: A Review of Public-Private Partnerships and Privatisation* (2001) <www.auscid.org.au/home2/downloadproc.php?id=80> at 15 October 2006.
- 29 Table 1 is adapted from a table in Linda M English and James Guthrie, 'State Audit of Public Private Partnerships in Australia: A Lack of Public Accountability?' (Paper presented at the 5th International Conference on Theory and Practice in Performance Measurement, London, 25–28 July 2006).
- 30 The Australian Council for Infrastructure and Development ('AusCID') databases reflect whole of life costs on a net present cost from a consortium perspective, that is, the AusCID figures represent only the estimated costs of projects to consortia members. Thus, the AusCID figures exclude some government costs. This indicates that from a public oversight perspective the AusCID databases understate the true cost of PPP projects because they omit government financing and other costs associated with PPPs, including pre-contractual costs and costs associated with other obligations undertaken by governments to get PPP projects up and running. It is also possible that PPPs entail greater post-contractual monitoring costs than other procurement models. For instance, the Sydney Cross City Tunnel included pre-contractual costs incurred by the Roads and Traffic Authority of \$100 million and the cost of changes to surrounding roads: Darren Goodsir, 'What the Fine Print Said – Force More Drivers Through the Tunnel', *The Sydney Morning Herald* (Sydney), 11 October 2005, 1. Problems associated with determining the true cost of PPPs to governments are further illustrated by the fact that government websites and the reports of auditors-general provide different costs for some projects.
- 31 It is likely that costs assigned to PPPs on government websites are also calculated on a net present cost whole of life basis as this is the approach adopted in PPP steering mechanisms. However, it is not possible to check that assumptions underlying net present cost calculations are identical.

Table 1: Overview of the Financial Value, Category and Auditor-General Oversight of the PPP Activity in Australian Jurisdictions as at December 2006

Category	Data	Jurisdiction										Grand Total	
		Multi	NSW	NT	Qld	SA	Tas	Vic	WA				
Correcional	Value (\$m)	25			89	0 [†]		1 370	[780]	79		1 563	[780]
	Number of Projects	1			2	1		8	[3]	1		13	[3]
Education	Value (\$m)		315		240			90				645	[315]
	Number of Projects		2	[2]	1			1				4	[2]
Energy	Value (\$m)	1 450	717		380	820	78	874		863		7 493	
	Number of Projects	4	5		1	4	1	10		7		39	
Entertainment	Value (\$m)		703		1 100			1 066				2 869	
	Number of Projects		2		1			4				7	
Health	Value (\$m)		359		561		30	1 019		700 [†]	[700]	2 669	[700]
	Number of Projects		4		1		1	4		2	[1]	12	[1]
IT	Value (\$m)							360				360	
	Number of Projects							3				3	
Justice	Value (\$m)							140		210		350	
	Number of Projects							1		2		3	
Rail	Value (\$m)	1 300	266		223			4 362	[2 941]			6 151	[2 941]
	Number of Projects	1	2		1			6	[4]			10	[4]
Road	Value (\$m)		7 550	[3 531]	82			4 455				12 087	[3 531]
	Number of Projects		9	[6]	1			3				13	[6]
Waste	Value (\$m)				105							105	
	Number of Projects				1							1	
Water	Value (\$m)		658		70	324		325				1 377	
	Number of Projects		5		2	6		9				22	
Total Value (\$m)		2 750	10 593	[3 846]	1 480	1 144	108	14 061	[3 721]	1 852	[700]	35 669	[8 267]
Total Number of Projects		5	30	[8]	2	11	2	49	[7]	12	[1]	127	[16]

Queensland's Gateway Bridge (1980) is the earliest project included in this Table.

The figures within square brackets printed in **bold italics** within each cell indicate the number and net present cost of PPPs that have been subject to performance audit within each category by jurisdiction.

[†] The net present costs of two projects (Mount Gambier Prison (South Australia) and South-West Health Campus (Western Australia)) were not ascertainable.

Table 1 indicates that Victoria is the dominant Australian jurisdiction in relation to both the number of PPP projects and the total net present cost of those projects. Of the 127 projects, 38.6 per cent (49 projects), worth 39.4 per cent (\$14 061 million) of the total PPP net present cost, are located in Victoria. Twenty three point six per cent (30 projects), accounting for 29.7 per cent (\$10 593 million) of total PPP net present cost, are based in NSW. At the end of 2005, neither the Commonwealth nor the Australian Capital Territory were party to any PPP projects.³²

Despite comprising only one-tenth of the total number of projects, road projects account for one-third of spending on PPP projects. On the other hand, the 22 water projects, representing one-sixth of the total number of projects, account for only 4 per cent of the net present cost of all PPPs. Other significant project categories are the correctional and health sectors. Whilst correctional projects outnumber health projects by 13 to 12, the cost of the health projects greatly exceeds the cost of the correctional projects. Health projects account for 7.5 per cent of the total net present cost of the 127 projects, whereas correctional projects account for 4.4 per cent of the total net present cost.

It is difficult to draw conclusions about observed project allocations, other than to speculate that they are more likely to flourish in circumstances that are not highly politically charged, in which risk can most easily be transferred to the private sector, and which provide private consortia with relative certainty of achieving desired returns.

32 Nevertheless, both the Commonwealth and ACT each have PPP policies. Moreover, the Commonwealth Department of Defence is, at the time of writing, shortly expected to finalise a PPP for the Headquarters Joint Operations Command Project: see Department of Financing and Administration, *Commonwealth Policy Principles for the Use of Private Financing* (2002) <http://www.finance.gov.au/GBPF/Docs/PF_Principles.pdf> at 15 October 2006; Department of Finance and Administration Financial Management Group, Commonwealth of Australia, *Commonwealth Procurement Guidelines*, Financial Management Guidance No 1 (2005) <http://www.finance.gov.au/procurement/docs/CPGs_-_January_20051.pdf> at 15 October 2006; Australian Capital Territory Government Procurement Board, *Implementing Private Provision of Public Infrastructure Projects in the ACT*, Procurement Circular 2003/03 (2003) <[http://www.basis.act.gov.au/basis/manactp.nsf/alldocs/638C906981AD7A8C4A256D38007BBE6D/\\$File/PPPI_May03.doc](http://www.basis.act.gov.au/basis/manactp.nsf/alldocs/638C906981AD7A8C4A256D38007BBE6D/$File/PPPI_May03.doc)> at 15 October 2006; Department of Treasury, ACT, *Statement of the Objective and Principles for the Private Provision of Public Infrastructure* <http://www.treasury.act.gov.au/documents/pppi_obj_principles.pdf> at 15 October 2006; ACT Government Procurement Board, *Private Provision of Public Infrastructure in the ACT – The Public Sector Comparator: An ACT Government Procurement Board Tool* (2003) Buyers and Sellers Information Service <[http://www.basis.act.gov.au/basis/manactp.nsf/alldocs/46C82B33FC4A1A1F4A256DA900004E77/\\$File/PSC%20Guide%20June03.pdf](http://www.basis.act.gov.au/basis/manactp.nsf/alldocs/46C82B33FC4A1A1F4A256DA900004E77/$File/PSC%20Guide%20June03.pdf)> at 15 October 2006; ACT Government Procurement Board, *Private Provision of Public Infrastructure in the ACT – Risk Allocation and Contractual Issues: An ACT Government Procurement Board Tool* (2003) Buyers and Sellers Information Service <[http://www.basis.act.gov.au/basis/manactp.nsf/alldocs/58C34B5CE56197EC4A256DA80082AA83/\\$File/PPPI%20Risk%20Guide%20June03.pdf](http://www.basis.act.gov.au/basis/manactp.nsf/alldocs/58C34B5CE56197EC4A256DA80082AA83/$File/PPPI%20Risk%20Guide%20June03.pdf)> at 15 October 2006.

VII INDEPENDENT OVERSIGHT OF PPP ARRANGEMENTS IN AUSTRALIA

For citizens, and presumably governments, the service provision is not just about realising lowest prices and associated efficiencies. In the Australian historical, social, economic and political context, it is also about adequacy, quality and accessibility of services provided, maximising overall VFM, ensuring proper accounting for the use of public resources, and the achievement of agreed results that often involve a significant non-monetary element. Thus, considerations of public interest and public accountability are also relevant to outsourcing decisions.³³

The need for independent inquiry into PPP arrangements is recognised in Australia and internationally.³⁴ Greve and Hodge note the scepticism with which many commentators assess PPP outcomes.³⁵ Research into Australian PPPs has concluded that the departments of treasury are the sole agenda-setters, rule makers and evaluators of PPPs.³⁶

In most OECD nations, auditors-general traditionally provide independent oversight of the activities of executive government and its agents, reporting their findings directly to Parliament, thus playing a crucial role in public accountability.³⁷ In order to determine the extent of independent oversight of Australian PPPs, an investigation³⁸ was recently undertaken to determine the focus and extent of Australian state performance audits into these schemes.³⁹

Table 1 shows (in bold italics) the categories and value of projects that have been the subject of performance audits by Australian auditors-general.⁴⁰ Of the 11 categories of PPPs only four – road, rail, health and correctional – have been performance audited in three jurisdictions: NSW, Victoria and Western Australia ('WA'). Table 1 also reveals that over a 22 year period 16 (12.6 per cent) individual PPP projects with a net present cost of \$8 267 million (23.2 per cent) have been audited by Australian auditors-general. One hundred and twenty-one projects worth \$27 402 million have not been subject to independent oversight by Australia's auditors-general. NSW has performance audited eight out of a total of

33 Lee D Parker and Graeme Gould, 'Changing Public Sector Accountability: Critiquing New Directions' (1999) 23 *Accounting Forum* 109; Pat Barrett, 'Accountability and Permanence in a Riskier Public Sector Environment' (Speech delivered to Senior Western Australian Public Sector Executives, CPA Australia, Perth, 27 November); English, Guthrie and Parker, above n 2, 23.

34 Broadbent and Laughlin, above n 13; English and Guthrie, 'Driving Privately Financed Projects', above n 6; Jane Broadbent, Jas Gill and Richard Laughlin, *The Private Finance Initiative in the National Health Service: Nature, Emergence and the Role of Management Accounting in Decision Making and Post-Project Evaluation* (2004); Edwards et al, above n 16.

35 Greve and Hodge, above n 1, 1, 8 ff.

36 English and Guthrie, 'Driving Privately Financed Projects', above n 6, 502 ff.

37 E L Normanton, *The Accountability and Audit of Governments: A Comparative Study* (1966) 1 ff.

38 English, 'Investigating Performance Auditing', above n 4.

39 The purpose of performance audit is to determine whether programs and policies have been implemented economically, efficiently and effectively. It has evolved in response to the introduction of new public management ('NPM') and it has been influenced by and influences NPM implementation: *ibid*.

40 Australian auditors-general undertake a range of audits. The performance audits reported here are those identified as such by auditors-general and are published in stand-alone reports.

30 PPP projects, Victoria has audited seven of a total of 49 projects, and WA one out of a total of 12 projects. No performance audits have taken place in Queensland, South Australia or Tasmania, despite the cost and number of PPPs that have been entered into.

In NSW, five of the performance audits relate to six toll roads. Three of these were requested by the NSW Parliament,⁴¹ indicating the controversy surrounding them. In Victoria, performance auditing has focused on comparing the performance of privately and publicly operated prisons, and on the negotiation of new public transport franchise contracts. The two performance audits into the Joondalup Health Campus (WA) are the only examples of a state audit of both pre-contractual and post-contractual stages of a particular PPP project.

The investigation into performance audits indicates that they are not a fixed, technical activity; rather, they are malleable and change over time. Different auditors-general both within and between jurisdictions have varying approaches to performance auditing, despite having very similar legislative mandates. This finding suggests that in interpreting their legislative mandates, auditors-general create a de facto mandate potentially open to challenge by executive government. This occurred in the Victorian performance audit of the three PPP prisons⁴² and in the first NSW audit of the Sydney Harbour Tunnel.⁴³ In the Victorian audit, the Government refused to allow the Auditor-General to provide financial information relating to PPP contracts. In the NSW audit, the Roads and Traffic Authority challenged the Auditor-General's right to conduct the audit and tried to stop it. Although there is a legislative prohibition on auditors-general commenting on the efficacy of government policy, one NSW auditor-general, in two separate audits, questioned the government's assumption that championing private toll roads resulted in effective public policy outcomes. These observations confirm the contested nature of performance audits and their dependence on situationally-specific context-bound factors.⁴⁴

The investigation identified an 11-element Australian PPP performance audit framework derived from PPP policies.⁴⁵ Mapping the extent and focus of PPP performance audits against this framework indicated that eight out of the 10

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- 41 New South Wales Auditor-General, *Performance Audit Report: Roads and Traffic Authority: The M2 Motorway* (1995) was initiated by a Legislative Assembly resolution carried on 22 November 1994: see New South Wales, *Parliamentary Debates*, Legislative Assembly, 22 November 1994, 527. New South Wales Auditor-General, *Performance Audit Report: Review of Eastern Distributor* (1997) NSW Auditor-General's Reports <<http://www.audit.nsw.gov.au/publications/reports/performance/1997/edist/contents.htm>> at 15 October 2006 was initiated by a Legislative Council resolution carried on 17 April 1997: see New South Wales, *Parliamentary Debates*, Legislative Council, 17 April 1997, 11150–1. New South Wales Auditor-General, *Auditor-General's Report to Parliament – Review of M2 Motorway Documentation* (2000) vol 3 followed a Legislative Council resolution carried on 21 October 1999: see New South Wales, *Parliamentary Debates*, Legislative Council, 21 October 1999 (Richard Jones).
- 42 Victorian Auditor-General's Office, 'Victoria's Prison System: Community Protection and Prisoner Welfare' (Special Report No 60, Victorian Auditor-General's Office, 1999).
- 43 New South Wales Auditor-General, *Private Participation in the Provision of Public Infrastructure: The Roads and Traffic Authority* (1994).
- 44 Lee D Parker and James Guthrie, 'Performance Auditing: The Jurisdiction of the Australian Auditor-General – De Jure or De Facto?' (1991) 7 *Financial Accountability and Management* 107.
- 45 English, 'Investigating Performance Auditing', above n 4.

audits focused on the pre-contractual stage of the investigated PPPs. Nevertheless, PPP performance audits appear less concerned with checking adherence to processes mandated in PPP policies and more concerned with substantive matters.

The performance audit literature distinguishes between two types of performance audits. Substantive audits investigate the effectiveness of policy implementation.⁴⁶ Systems-based audits interrogate adherence to policies and procedures mandated by the audited bodies themselves. The research indicates that five of the PPP audits are substantive, and five are systems-based.⁴⁷ In substantive audits, auditors-general have examined matters such as whether risks have actually been transferred to private road operators (NSW Auditor-General) and whether key performance indicators permit the achievement of core correctional services objectives (Victorian prison audit).

VI CONCLUSION

PPPs present unique challenges to governments and auditors-general. Governments justify their use on the basis of risk allocation which produces anticipated VFM. Accordingly, confirming the achievement of VFM savings in the operating stage would appear to be at the heart of PPP oversight, both by sponsoring agencies and auditors-general. The post-2000 focus in steering mechanisms on VFM outcomes, as opposed to the procurement of off-balance sheet assets, appears to indicate that most Australian PPP assets may be recognised on government balance sheets, ensuring that government debt is not understated.⁴⁸ However, there has been no independent research verifying the post-2000 accounting treatment of PPPs.

Similarly, there is little publicly available information about, and there has been no research into, the extent and outcomes of agency monitoring of the post-contractual stage of PPPs. Do agencies determine whether VFM has been achieved in the post-contractual stage, and, if so, what methodology do they use?

Confirming VFM in the operating stage is problematic and also does not appear to have been widely investigated by Australian auditors-general. The study into audit reports found that changes in anticipated risk allocations in the

46 There is general agreement in the performance audit literature that substantive audits are preferable to systems-based audits because they provide independent assessment of the effectiveness of the implementation of government policy and, sometimes, of the effectiveness of the policies themselves. Systems-based audits tend only to address economy and efficiency, but not effectiveness. See English, 'Investigating Performance Auditing', above n 4.

47 Ibid.

48 A recent article by Scheherazade Daneshkhu ('PFI Figures Are a "Step Forward in a Murky Area"', *The Financial Times* (London), 21 September 2006, 27) suggests that in the UK, at least, there is still controversy over the accounting treatment of PPPs, which indicates lingering doubt about their nature and purpose. Daneshkhu reports that, after five years of deliberation, the UK Office of National Statistics ('ONS') has valued PFI debt at £4.95 billion, which it added to public sector net debt. However, controversially, the ONS excluded debt associated with PFI hospitals, which, in some cases, appears neither on government nor on consortia balance sheets. The total capital value of PFI projects signed by March 2006 was £48 billion, £23 billion of which is recognised as government debt. The balance is off-balance sheet because of a HM Treasury judgment that the risk is in the hands of the private sector.

post-contractual (construction and operating) stage of PPPs had only been subject to investigation in four of 10 identified stand-alone performance audits. Three of those audits were classified as substantive and provided analysis of the effect of changes in risk premiums and their impact on returns to the state, on PPP term and tolls, and on the use of public money in toll road projects. The systems-based audit into a pre-2000 PPP hospital delivering core medical and other services merely noted that the effect of the identified change in risk premiums was marginal. That study also demonstrated that the pre-contractual stage had been the focus of eight of the 10 performance audits, suggesting that Australian auditors-general may need to put more resources into auditing PPP arrangements, and to focus their efforts on investigating the achievement of anticipated VFM to provide some assurance that government policy is being implemented effectively.

Not all PPP projects, or even all PPP categories, appear to have been subject to systematic performance auditing by Australia's auditors-general. A study conducted by English and Guthrie in 2003 suggested that auditors-general play a relatively insignificant role in PPP oversight.⁴⁹ Evidence presented by English in 2006⁵⁰ indicates that the record of Australian auditors-general is patchy. It appears that no audit office has consistently or strategically performance audited a range of PPP projects. If auditors-general are not performing a significant PPP oversight role, the question asked by English and Guthrie⁵¹ as to who has taken responsibility for the oversight of PPPs remains unanswered.

49 English and Guthrie, 'Driving Privately Financed Projects', above n 6, 505 ff.

50 English, 'Investigating Performance Auditing', above n 4.

51 English and Guthrie, 'Driving Privately Financed Projects', above n 6, 495.