Managing accountability risks in public-private partnerships

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Executive summary

The Government of Saskatchewan is exploring the use of public-private partnerships to increase its flexibility in pursuing public goals. This involves the government using entities outside of government to deliver services, including the building and maintaining of infrastructure. Although the government has for years used outside entities to provide specific services, public-private partnerships would involve more significant transfers of risk and sharing of authority with the non-public sector. As a result, maintaining public accountability may be more complicated.

In this chapter, we describe best practices that the Government of Saskatchewan should follow to manage the accountability risks associated with public-private partnerships:

1. Set out guiding principles in legislation or policy for the use of public-private partnerships.
2. Ensure the Government and its partners have adequate capacity to enter into and carry out public-private partnerships.
3. Agree upon plans to carry out public-private partnerships.
4. Require effective reports on performance of public-private partnerships.
5. Ensure reasonable reviews of performance of public-private partnerships.

We urge the Government to follow these practices as it considers public-private partnerships. We expect to examine and report on public-private partnerships that the Government undertakes.

Introduction

Governments have been exploring different ways of providing services, including the building and maintaining of infrastructure. Some involve working with entities outside of government. One label that has been used to describe these arrangements between governments and entities outside of government is “public-private partnership” or “P3.” While this term implies partnership with a private sector organization, partnerships could involve other non-public organizations, such as not-for-profit or community-based organizations.

When governments turn to organizations outside government to provide services, it can complicate accountability. By accountability, we mean the government demonstrating responsible action and reporting its performance in light of its plans. In entering into P3 relationships, governments must ensure that accountability for public money is maintained.

The Government of Saskatchewan is exploring the use of P3s to deliver services. For this reason, we describe in this chapter best practices that the Government of Saskatchewan should follow to manage the accountability risks associated with P3s. Our focus is on what the Government should do to manage accountability risks; we do not describe best practices for managing the operation of a P3. The Government of Saskatchewan has given Crown Investments Corporation of Saskatchewan (CIC) the mandate to coordinate the delivery of P3 options across the entire Government.

To develop these best practices, we reviewed Canadian and international literature and reports of other auditors concerning P3s. We considered government guidelines on P3s. We consulted with the Department of Finance, CIC and other legislative audit offices regarding the best practices.

Background

What is a public-private partnership?

The term "P3" has been used to cover a broad range of interaction between government and non-governmental organizations. This has created confusion. Although the government has for years used outside entities to provide specific services, public-private partnerships would involve more significant transfers of risk and sharing of authority.

We use P3 to refer to arrangements where government works with entities outside of government to provide services that have traditionally been delivered by the public sector.

P3s generally include the following common elements:

- co-operative pursuit of shared or compatible objectives;
- mutual benefit;
- risk sharing;
- best use of public resources;
- joint investment of resources; and
- sharing of authority.

P3s vary in how they allocate risk, reward and responsibility between government and non-governmental partners. On one end of the spectrum, a P3 may involve a partner simply contributing resources to a government program (for example, a private company contributing to a government training program in order to benefit from a more qualified workforce). At the other end of the spectrum, a partner may design, build, operate and own an asset that is used to provide public services. This level of involvement means the partner takes on risks (e.g., construction risks, usage risks) and will expect to be rewarded accordingly.

P3s also vary in how they are structured. In some cases, the relationship is simply based upon transactions, such as the partner contributing resources to a government program. At the other end of the spectrum, the government, together with the partner, may set up a separate entity to carry out the P3.

This chapter focuses on co-operative projects involving more significant transfers of risk and sharing of authority with the private sector.

Why use a public-private partnership?

Proponents cite several reasons for using P3s. They state that P3s can reduce government cost, improve service, build on private sector expertise, and promote economic development.

In the past, some governments used P3s as a way to avoid taking on debt. Instead of the government borrowing money to build an asset, it would have a partner build the asset. The government would then pay the partner a fee to use the asset. As a result, the government's finances would look better because no debt would be recorded on the government's books. However, the reality in many cases was that the government retained the significant risks associated with the asset. Therefore the asset really belonged to the government, as did the debt. The Canadian Institute of Chartered Accountants has new accounting rules that require the accounting for these arrangements to reflect the underlying reality.[1]

There are other reasons for use of P3s. P3s can be used to transfer risk and allocate potential rewards, and to build incentives into projects that will promote improved performance. Ultimately, working collaboratively with others should allow governments a broader range of resources, tools and options to assist them in carrying out their responsibilities.

> For too long there has been a lack of diversity in the way in which public services are provided and projects are procured. Government has tended to rely on too limited a pool of service providers and too restrictive an approach towards undertaking large capital projects. This has resulted in public services missing out on the skills, creativity, and areas of expertise that reside in a wide range of private and voluntary organizations. This means less choice for public authorities, less innovation than may otherwise be the case, and less scope for learning within public service organizations.[2]

There are also cases where the use of P3s is not appropriate. Governments should not use P3s where government control over public policy would be jeopardized. Governments should not use P3s where there is no prospect, for policy or operational reasons, of transferring

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[1] The Canadian Institute of Chartered Accountants, (April 2000).
[2] Institute for Public Policy Research, (June 2001), p.1.

significant control and risk to the private sector without disproportionate cost.[3]

Accountability risks

P3s could create accountability risks for governments and citizens such as:

- avoidance of public accountability mechanisms;
- difficulty in measuring cost-benefit;
- loss of public control over important assets;
- circumventing government control practices;
- ineffective transfer of risk to partners.

Some accountability risks may relate to Government and partner expectations regarding confidentiality. Confidentiality should not be allowed to override the need for the Government to be accountable for its use of public resources. The risk is that to accommodate the private sector's desire for confidentiality, transparency in spending of public money may be compromised. One author has noted "…it is striking how government representatives have acquiesced to demands by their private partners that the details of their contracts remain confidential, thus blurring the lines of accountability."[4]

However, while the Government must account for its use of public resources in the partnership, the private partner should not be forced to disclose commercially sensitive information that would impair its competitive position.

Other accountability risks may relate to the structure of the P3 arrangements, particularly where it involves the creation of a new entity to carry out the P3. That entity must not be regarded as being outside of Government, and thus not subject to normal accountability through the Legislative Assembly. Although the Government can delegate authority to do specific tasks, it cannot delegate its responsibility. It is always answerable to the Legislative Assembly for its stewardship of public money. Working with a partner does not lessen the Government's accountability in any way.

[3] British Columbia. Ministry of Employment and Investment, (January 1998), section 2.
[4] Joan Price Boase, (Spring 2000), p. 88.

Best practices

In this section, we describe best practices for Government to manage accountability risks associated with P3s. We list these best practices in Exhibit 1.

The first two best practices are preconditions for the use of P3s. The three remaining best practices describe necessary elements of all public accountability systems. These are:

- agreed-upon plans (that are clear as to responsibilities, authorities, performance targets, and resources needed);
- reliable reports on performance; and
- reasonable reviews of performance.

The last three best practices are described in more detail in Chapter 1 of our 2000 Spring Report.

Exhibit 1

To manage accountability risks associated with public-private partnerships, the Government should:

1. set out guiding principles in legislation or policy for the use of public-private partnerships
   - confirm guiding principles with stakeholders
   - distribute guiding principles
   - integrate guiding principles into operating practices

2. ensure the Government and its partners have adequate capacity to enter into and carry out public-private partnerships
   - confirm legislative authority to enter into agreements
   - assess adequacy of resources (e.g., expertise to knowledgeably supervise activities and results, adequate information and money available)
   - confirm partner's recognition of the Government's public sector accountability and commitment to guiding principles

3. agree upon plans to carry out public-private partnerships
   - clarify roles and responsibilities of the Government, partners and partnership (including any entity created)
   - establish clear objectives for the partnership (e.g., best result for the least cost using a public sector comparator, acceptable level of risk and reward)
   - set clear performance targets focusing on outcomes
   - incorporate change management and dispute resolution processes

4. require effective reports on performance (see Exhibit 2) of public-private partnerships
   - respond to information needs of stakeholders
   - describe results achieved by partnership (achievement of objectives and performance targets)

- ♦ comply with generally accepted accounting principles (e.g., new accounting rules governing the ownership of leased assets)
- ♦ ensure reports are made public in timely way
- ♦ provide for independent verification of the reliability of financial and performance information

5. ensure reasonable reviews of performance of public-private partnerships
   - ♦ set clear evaluation criteria
   - ♦ ensure the Government and partners can access performance information
   - ♦ provide for transparent public access to performance information of partnership
   - ♦ require regular legislative review of performance of partnership
   - ♦ provide for shared learning
   - ♦ assign responsibility for compilation of lessons learned
   - ♦ assign responsibility for communication of lessons

1. Set out guiding principles in legislation or policy for the use of public-private partnerships

To follow best practices for managing accountability risks associated with P3s, the Government should set out the principles and values that will guide its use of P3s (e.g., transparency). These guiding principles would apply to the use of P3s generally, and would not be specific to any particular P3 project. It is important that the Government articulate these principles and values in order to provide guidance for those involved in setting up P3 arrangements. We note that the Government is working on guiding principles for P3s.

The Government should confirm these principles with its stakeholders through public consultation. Stakeholders include the public, Government agencies, and potential partners. The Government should also make the guiding principles available to its stakeholders. Operating practices for P3s should incorporate the guiding principles and should be co-ordinated across the Government.

2. Ensure the Government and its partners have adequate capacity to enter into and carry out public-private partnerships

To follow best practices for managing accountability risks associated with P3s, the Government should ensure that it has adequate capacity to negotiate and carry out successful P3s. It should also ensure that its prospective partners have adequate capacity.

The Government, in assessing its capacity, should consider whether it has sufficient legislative authority to enter into the P3. The Government also needs to assess the adequacy of resources it has available. It will need expertise, for example, to knowledgeably supervise activities and results. It will require adequate information to support its decisions. Finally, it should ensure that it will have sufficient money to support its participation in the planned P3 over the life of the arrangement.

In choosing a partner, the Government should ensure that the partner also has adequate expertise, information and resources. It should also consider whether the partner has previous experience with P3s.

Working with a partner does not lessen the Government's accountability for its use of resources. The Government should confirm that the partner recognizes that the Government retains its public sector accountability and agrees to use the stated principles for use of P3s.

3. Agree upon plans to carry out public-private partnerships

To follow best practices for managing accountability risks associated with P3s, the Government should ensure that plans for P3s set out clear roles and responsibilities, objectives, and performance targets. These should be clear for the Government, the partners and the partnership. Plans to create and carry out the partnership may be found in more than one document, for example, in a business plan and later in a contract to carry out the P3.

The plans must specify the roles and responsibilities for all participants. This includes the Government, partners, and the partnership (including any entity created specifically for the P3). The plans should indicate the contractual obligations of the Government and the partners. It should describe who is accountable for what and to whom. The plans should specify how reporting should take place. They also need to describe the Government's and the partners' resource contributions.

The plans must establish clear objectives for the P3. The guiding principles should help the Government determine the objectives it will seek through the use of the P3.

Although different P3s will have different operational objectives, a common goal for all will be to achieve the best use of public resources (i.e., the best result for the least cost). To compare costs, the Government should compare the public sector cost for providing the service (called the "public sector comparator") to the cost of providing the service using a P3. This comparator must be constructed with care to ensure a fair comparison of the full costs. The Government will also need to evaluate whether a P3 will deliver the best result (e.g., quality, quantity or timing) compared to other methods.

Another reason that a government participates in a P3 is to share the risk involved in a project. The private sector partner will be willing to assume risk provided there is the potential for adequate reward. The Government could structure the P3 so that these rewards function as "built in" incentives that will promote achievement of the Government's objectives. For example, if under a contract the private sector partner will eventually take ownership of an asset, it will have an interest in ensuring proper maintenance is done throughout the life of the contract. The contract should be structured so as to take advantage of that interest.

It is not enough to have an objective. One must know if objectives have been achieved. It is, therefore, an important best practice that the plans for a P3 set out clear performance targets. Clear performance targets allow the partners to assess if they are succeeding in what they have set out to do.

The performance targets should focus on outcomes. That is, the plan should clearly set out the desired consequence or results of the P3's activities. The plan should identify the specific measures that the partners will use to evaluate whether they are meeting those targets. The Government should consult with stakeholders (including the public, related Government agencies, and partners) in selecting performance measures. We note that the Government will have to know what its targets are in order to calculate what the costs for providing the service would have been under the public sector (see the discussion regarding the "public sector comparator" above).

Finally, a good plan will anticipate that difficulties can develop. Therefore, plans for P3s should include change management and dispute resolution processes.

Some jurisdictions are examining the establishment of a framework for developing and implementing P3s. Opinions vary on how standardized and rigid the prescribed process should be. The advantages of strict adherence to a framework include clear expectations of participants' responsibilities and steps, and less cost reinventing new structures. However, too rigid a process also places at risk one of the advantages of a P3, which is to permit the public and private sectors to be innovative in achieving goals.

4. Require effective reports on performance of public-private partnership

To follow best practices for managing accountability risks associated with P3s, the Government should ensure that P3s report effectively. The Government's obligations under a contract cannot lessen its accountability to the Assembly for its use of the powers and the resources entrusted to it. The Assembly needs to receive relevant and reliable information about the Government's planned and actual performance to hold it accountable. In addition, partners and stakeholders of P3s require effective reporting to ensure their objectives are being met.

Effective reports are relevant, reliable, and understandable (see Exhibit 2).

Exhibit 2

Effective performance reports are:

Relevant

- focus on plans and results,
- show how results were achieved,
- set out the cost of results,
- measure something of significance to users, and
- reported in sufficient time to influence decisions.

Reliable

- are accurate and complete,
- are capable of being replicated or verified, and
- are neutral and fair.

Understandable

- balance conciseness with completeness,
- show comparative information consistently,
- are aggregated at an appropriate and meaningful level, and
- describe performance in the context of control and risk.

Source: p. 35, 2001 Spring Report of The Provincial Auditor Saskatchewan.

In particular, a P3's performance reports should provide information that stakeholders need. The reports should describe what was done and the results achieved by the partnership. The reports should describe progress toward achieving objectives and provide explanations for the objectives that have not been achieved.

The reports should describe the partnership arrangement and how well it worked. It should also describe the benefits achieved through use of the partnership arrangement compared to more traditional approaches.

The performance reports need to be accurate and complete. The financial component of the performance report must comply with Generally Accepted Accounting Principles and reflect the underlying substance of the arrangement.

Effective P3 reports also require independent verification of the reliability of financial and performance information.

> …where the independent entities involved in delegated arrangements provide performance reports through ministers to Parliament, the fairness and reliability of the performance information ought to be subject to assessment by an external auditor, paralleling the well-accepted model for financial information. [5]

5. Ensure reasonable reviews of performance of public-private partnerships

To follow best practices for managing accountability risks associated with P3s, the Government should ensure that it reviews the performance of P3s.

As noted in #3, the plan for the P3 should describe clear performance targets. Based on these performance targets, the Government should decide how to evaluate the level of performance.

It is important that the Government and its partners have access to performance information for the partnership. As well, the public should have access to the performance information. Because the nature of a P3 is that the fulfillment of public policy is one step removed from direct

[5] Canada, Office of the Auditor General, (April 1999), Chap. 23, para. 23-105.

ministerial control, the importance of public transparency is heightened.[6] This need for public transparency applies to the partnership, and does not mean that the individual private sector partners must open all their books to greater public scrutiny.

The performance of the P3 should be subject to legislative review. In Saskatchewan, Government agencies are accountable to the Legislative Assembly for what they achieve with the resources provided to them. Government agencies report to the Legislative Assembly through one of two committees, the Public Accounts Committee or the Crown Corporations Committee. Government agencies involved in P3s will also have to report to the Legislative Assembly, through their respective legislative committee, for the performance of the partnership. Again, this does not mean that the private sector partner will have to report to a legislative committee. The partner is within an accountability relationship defined by the contract for the P3, and is not under a direct accountability relationship with the Legislative Assembly.

Finally, it is important that the Government take steps to share the lessons that will arise out of reviews of performance. The Government should assign responsibility for compiling the lessons learned and communicating them to those involved in other partnership projects.

Conclusion

P3s offer governments increased flexibility in pursuing public goals. This complements governments' increasing focus on the results they achieve rather than on how they achieve them.

However, the involvement of entities outside of government in delivering public services may blur the lines of public accountability. Accordingly, we urge the Government to consider these best practices for managing the risks to accountability. We recommend that the Government follow these practices as it considers P3 projects. We expect to examine and report on P3s that the Government undertakes.

[6] Ibid., para. 23-107.

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