



Contractmanagement in DBFMO





Contractmanagement in DBFMO projects

Original title

Algemene Rekenkamer (2013). Contractmanagement bij DBFMO-projecten. Tweede Kamer, vergaderjaar 2012-2013, 33 639, nrs. 1-2



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1 About this audit

1

1.1 Background

This audit considers central government's management of DBFMO contracts. The abbreviation DBFMO stands for the various stages in a project: Design, Build, Finance, Maintain and Operate. A DBFMO contract covers all stages of a project by means of a single contract concluded with a single procuring authority. An integrated DBFMO contract has advantages over the conclusion of separate contracts for each stage of a project. One of the advantages is financial added value.

More local authorities and organisations funded from the public purse, such as autonomous administrative authorities, schools and hospitals, have concrete plans to carry out DBFMO projects.¹

DBFMO contracts are a relatively new form of public private partnership. The Minister of Finance has been encouraging the use of DBFMO since 1998. At the end of 2012, 13 DBFMO projects were being carried out: six infrastructure projects and seven building projects (Ministry of Finance, 2012). The total value of the contracts exceeded €6 billion² and the projects' estimated financial added value³ was €800 million. About 20 projects are currently in the tendering or decision-making stage. This audit examined five DBFMO projects with a total contract value of €1.5 billion and an estimated added value of €265 million.

The Netherlands Court of Audit first audited DBFMO, specifically in the case of the HSL South high-speed rail link,⁴ in 2002. The DBFMO model is applied internationally in a similar way as in the Netherlands. Many of the

¹ www.ppsnetwerk.nl/Projects-Database

² This is the sum of the contract values based on net present value at the moment the contracts were concluded, excluding VAT. The ultimate expenditure for these contracts will be substantially higher.

³ Added value is the difference in cost between the public alternative and the bid by a private consortium. See section 1.2.2.

⁴ In 1990 and 1993, the Court of Audit published a report on the private financing of the Noord tunnel and the Wijkertunnel. In 2003, 2005 and 2007 we carried out several smaller audits on the HSL. In 2003 and 2005 we audited the risk reserve for the HSL and in 2007 risk management of the HSL.



projects have been audited and reviewed by the supreme audit institutions of the countries concerned. A meta-analysis of these international audits found that the DBFMO model was frequently used but that the implementation of the projects was not always successful (Boers et al., 2013). The government does not always succeed in protecting the public interest.

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The increase in the number of projects, their substantial financial importance and the risks highlighted internationally prompted us to carry out an audit of DBFMO projects in the Netherlands.

1.2 What is DBFMO?

Under a DBFMO contract, central government no longer procures a road or building but pays for its availability during the term of the contract. DBFMO is a form of public-private partnership in which:

- a. the various stages of a project are outsourced to a single consortium of private parties by means of an integrated contract. The consortium is established specifically to carry out the project and is made up of, for example, a constructor and a facility service provider;
- b. the contract has a long term, of between 15 and 30 years. The long term is necessary for the private consortium to recover its investment in the design and build stages at the beginning of the contract during the subsequent maintenance and operation stages;
- c. the private consortium is responsible for project financing. The private party is not paid on delivery of the asset but receives a monthly fee for the availability of the asset during the term of the contract (availability fee);
- d. the risks of the project are shared between the public and the private sector and are borne by the party that can best manage them.⁵

A DBFMO contract includes mechanisms to balance the interests of the private party with those of the public party. The main mechanism is the control mechanism that links the consortium's performance to the payment made by the government. The government makes the payment only when the agreed performance has been delivered. The delivery of the performance is determined by means of a monitoring system designed by the private party.

⁵ The design and build risks, for example, are borne by the contractor. Central government thus transfers responsibility (against a payment) for rectifying shortcomings in the design and build to the contractor.



1.2.1 Opportunities for DBFMO

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This section summarises some of the potential benefits of DBFMO. In comparison with other contract forms DBFMO can generate added value in terms of time, money and quality. Furthermore, DBFMO provides opportunities to reduce the size of the public sector and unburden the government of certain responsibilities during the term of the contract.

Integrated contract reduces costs

The integration of the design, build, finance, maintain and operate stages into a single contract can produce whole life optimisations.⁶ An integrated DBFMO contract is an incentive for private parties to anticipate technical practicability and the consequences of management and maintenance in the design. Optimisation of the operation and management stages are also part of the process. By taking account of all stages (and costs) of a project's whole life, the overall cost may ultimately be lower.

Insight into costs enables better decisions

A DBFMO contract provides an insight into the total cost throughout the entire life of the contract, including maintenance, replacement and facility costs as well as design and build costs. This insight provides the government with important information when deciding on alternatives.

Payment mechanism is an incentive to the contractor

The procuring authority pays the private party for an agreed level of service. The service level is at the heart of the agreement.⁷ The payment mechanism is also an incentive to complete a project quickly because the private contractor is not paid until a road or building is (and remains) available.

1.2.2 Added value calculation

The Minister of Finance has declared that DBFMO projects in the Netherlands have so far produced added value of €800 million (Ministry of Finance, 2012). This figure is based on the added value calculated by means of a Public Sector Comparator (PSC). A PSC calculates the estimated cost of the public alternative to determine whether it would be more cost effective to use a DBFMO contract or separate contracts. It also

⁶ See, for example, Ministry of Finance, 2010; Government Buildings Agency, 2008; Eversdijk and Korsten, 2008.

⁷ See, for example, Kenniscentrum PPS, 2003; 2008; Government Buildings Agency, 2008.

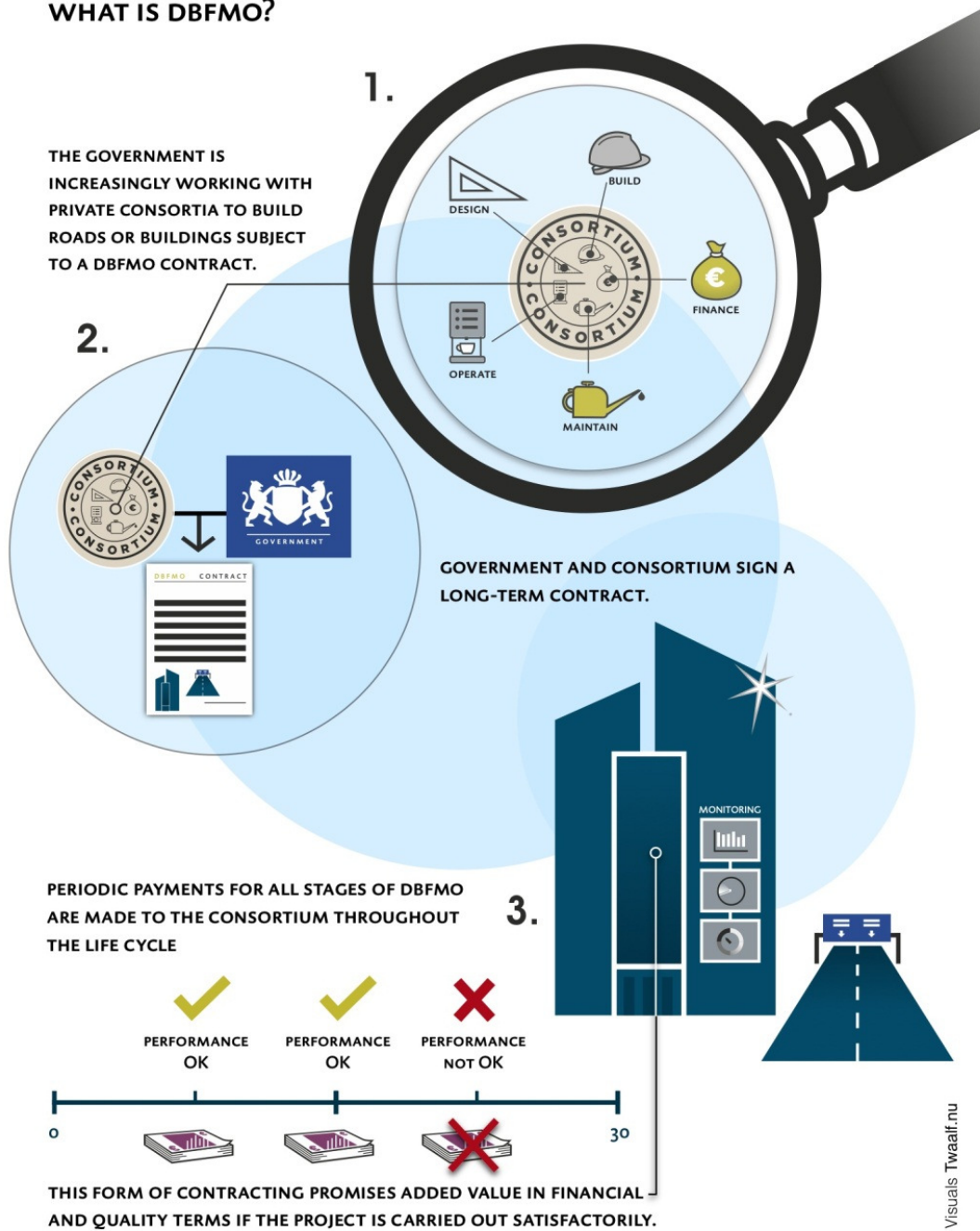


sets a ceiling or guideline price for the contract (Ministry of Finance, 2011b) (see also section 5.1.2).

Figure 1 DBFMO in a nutshell

DBFMO IN A NUTSHELL

WHAT IS DBFMO?





1.3 Audit approach

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The audit objective was to gain an understanding of the use of DBFMO in practice and specifically of the performance of contract management. International SAI audits have found that good contract management is decisive to retain both the financial and the qualitative added value of a DBFMO project throughout the term of the contract.⁸ DBFMO contract management has never previously been audited in the Netherlands.

The key audit question was whether the government steered and controlled the implementation of DBFMO projects so as to safeguard the public interests effectively. We also examined whether the House of Representatives was adequately informed of the financial and other consequences of DBFMO projects.

In concrete terms, we audited how the management mechanism had been applied and how contract changes had been dealt with on five projects. The total contract value of the five projects audited was €1.5 billion⁹ and the estimated added value was €265 million.

We had access to the main documents for each project, including the DBFMO contracts with all appendices, change contracts, communication between the government and the private consortium, such as minutes and correspondence, and data from the monitoring systems. We also interviewed the persons responsible for the day-to-day implementation of the contract and had access to logbooks. More information on the audit methodology is presented in appendix 1 and on the projects selected in appendix 2.

We do not make comparisons between DBFMO and more traditional forms of contracting in this report.

1.4 DBFMO in the Netherlands

This section first looks at policy responsibility for DBFMO contracts (section 1.4.1) and then considers the DBFMO projects that are being carried out or are in preparation (section 1.4.2).

⁸ See Boers et. al. (2013) and www.courtofaudit.nl/ppp for more information and an overview of relevant international SAI audits.

⁹ This is the aggregate contract value based on net present value when the contracts were concluded. Ultimate expenditure on these contracts will be substantially higher on account of the discount rate, VAT and contract variations.



1.4.1 Policy responsibility

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The Minister of Finance is responsible for coordinating DBFMO projects and for the relevant policy frameworks and their application. The individual line ministries are responsible for the implementation of their own projects.

The Minister of Finance has intentionally encouraged the use of DBFMO in the past decade. The government wants to maximise the benefits provided by this form of contract by using it on as many projects as possible. In principle, the government will opt for a DBFMO contract if it can generate financial added value. As a matter of policy, the suitability of a DBFMO contract for a particular project is determined at an early stage (Ministry of Finance, 2011a).

The potential projects must be financially significant because the cost of the preparatory stage is high and DBFMO is not cost-effective on a small project. The financial threshold for government buildings is €25 million and that for infrastructure projects €60 million. The added value is determined by the PSC (see also chapter 5).

1.4.2 DBFMO projects

The first DBFMO projects in the Netherlands were infrastructure projects: the High Speed Rail Line in 2001 and the N31 road in 2002. The first DBFMO contract for a building was signed in 2006 for the renovation of the Ministry of Finance in The Hague. The table below shows the projects currently being carried out and the projects for which the tendering process is in preparation (Ministry of Finance, 2012).

We audited three road projects commissioned by *Rijkswaterstaat*, the executive agency of the Ministry of Infrastructure and the Environment:

1. N31 Leeuwarden – Drachten;
2. A12 Lunetten – Veenendaal;
3. A15 Maasvlakte – Vaanplein.

We also audited two projects commissioned by the Government Buildings Agency, part of the Ministry of the Interior and Kingdom Relations:

1. Renovation of the Ministry of Finance in The Hague;
2. Rotterdam detention centre.



In the case of government buildings, the users are also important actors. The users of the two building projects we audited were the staff of the Ministry of Finance and of the Custodial Institutions Agency (part of the Ministry of Security and Justice) respectively.

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Current DBFMO projects, December 2012 (Ministry of Finance, 2012)

Infrastructure	Term	Final year	Indicative financial cost (€ million)¹⁰
Being implemented			
N31 Leeuwarden – Drachten*	15 years	2022	145
A12 Lunetten – Veenendaal*	20 years	2032	608
A15 Maasvlakte – Vaanplein*	20 years	2035	1,983
A10 Second Coen tunnel - Westrandweg	30 years	2043	2,016
HSL South	25 years	2031	3,563 ¹¹
A59 Den Bosch and Oss ¹²	15 years	2020	279
In preparation			
<ul style="list-style-type: none"> • A1/6/9 Schiphol – Amsterdam - Almere • N33 Assen – Zuidbroek • A12 Ede - Grijsoord • N18 Varsseveld - Enschede • Limmel sluice lock • Sea access at IJmond • Third outlet of the Beatrix lock • Eefde lock • Future of the Afsluitdijk 			

¹⁰ This is the overall project budget excluding VAT, as disclosed in the budget for 2013 (Minister of Infrastructure and the Environment, 2012: 28).

¹¹ Availability fee for the HSL South (infra provider) including VAT (Minister of Infrastructure and the Environment, 2012: 48).

¹² Project commissioned by the province of North Brabant.



Buildings	Term	Final year	Indicative financial cost (€ million)¹³
Being implemented			
Ministry of Finance*	25 years	2033	147.1
Rotterdam detention centre*	25 years	2035	80.8
Doetinchem tax office	15 years	2025	47
DUO Tax and Customs Administration, Groningen	20 years	2031	136.7
Construction of Schiphol custodial complex	25 years	2037	336
Kromhout barracks	25 years	2035	450 ¹⁴
National Military Museum, Soesterberg	25 years	2039	Not known ¹⁵
In preparation			
<ul style="list-style-type: none"> • Construction of the Supreme Court • Renovation of Rijnstraat • Zaanstad detention centre • Bezuidenhoutseweg 30 • National Institute for Public Health and the Environment / Ministry of Health, Welfare and Sport, Utrecht • Flushing naval barracks • Ministry of Defence surveillance and security system 			

* These projects were audited

The table above provides an indication of the projects' financial significance. The figures were derived from parliamentary papers from several years but it is not always clear what precisely the amounts represent. It is not known whether they refer to the contracts' net present value or total expenditure or whether they include contract changes. In respect of government buildings, the government informed us that the exact contract values and added value percentages were confidential.

¹³ The annual report of the Ministry of the Interior and Kingdom Relations discloses these amounts as 'off balance sheet assets and liabilities'. No further explanation is given (Minister of BZK, 2012: 214).

¹⁴ Net present value, probably in 2010. This amount is stated in a progress report issued by the Ministry of Finance (2012), but cannot be found in the State budget or the ministries' annual reports.

¹⁵ No public information on the project size or contract value is provided in the State budget or the ministries' annual reports.



1.5 Structure of this report

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Chapter 2 of this report presents our conclusions and recommendations. Chapter 3 considers the response of the relevant ministers to our audit, and our afterword. Chapters 4 and 5 provide background information on DBFMO contracts and outline the audit findings on which our conclusions are based. Chapter 4 looks at the management mechanism and contract changes. Chapter 5 presents our findings regarding the information the House of Representatives receives on DBFMO projects and the budgetary consequences of DBFMO.



2 Conclusions and recommendations

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We drew the following conclusions from our audit of the implementation of DBFMO projects:

1. Contract management in DBFMO projects is open to improvement. The management mechanism (performance-related payment) is not always applied as intended. It is an important tool to enforce contract agreements and protect the public interest. Strict contract management is a precondition to realise the expected financial added value of a DBFMO contract if it comes under pressure from changes made during the term of the contract.
2. The House of Representatives should receive more information on the implementation of DBFMO contracts. The House needs a clearer understanding of DBFMO and its long-term consequences so that it can form an opinion on the use and implementation of DBFMO projects.

2.1 DBFMO contract management

Strong contract management is an important mechanism to balance the interests of the government with those of the private contractor (section 2.1.1) and to realise the financial added value of DBFMO contracts if changes are made during the contract term (section 2.1.2).

2.1.1 Management mechanism

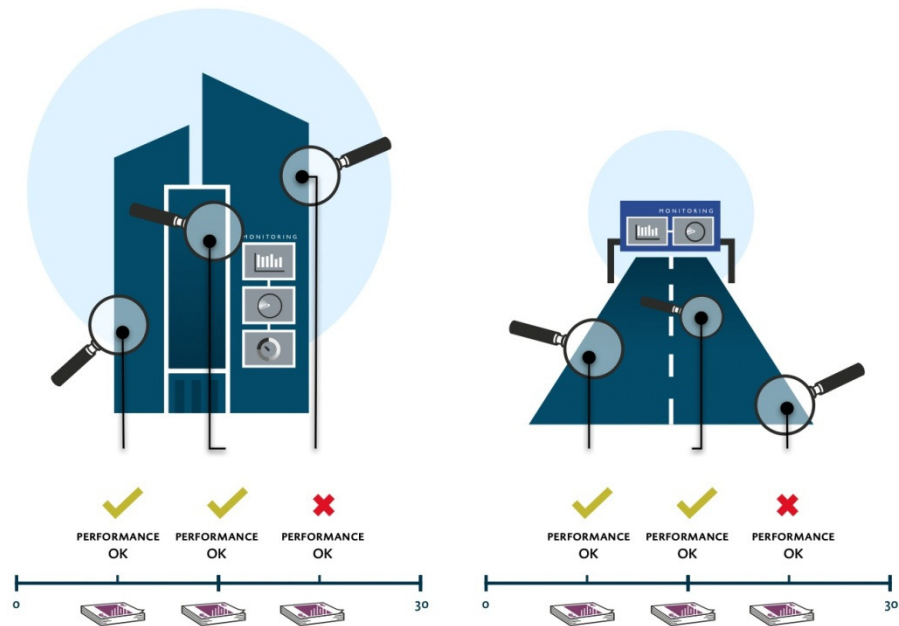
The main management mechanism in DBFMO is that the government pays for the agreed performance. If the consortium does not deliver the agreed performance in full or in part, the government will not pay the full availability fee. This mechanism gives equal importance to the interests of the government and those of the private consortium.

In practice, the contractual payment mechanism in the five projects we audited was clear. The government linked the greater part of the payments it made to the performance delivered.



We also found a number of problems: (1) the government does not always impose penalties or deductions, (2) the consortia's performance was not optimally monitored, and (3) the government makes guaranteed payments. These findings are inconsistent with the DBFMO principle and therefore compromise the relationship between the cost and the quality of a project. The three problems are briefly considered below.

Figure 2 Monitoring DBFMO projects



Visuals Twaalf.nu

PAYMENTS ARE NOT ALWAYS LINKED TO PERFORMANCE

Penalties and deductions are not always imposed

The government does not always apply the contractually agreed regime for penalties and deductions if performance is not satisfactory. In view of the long duration of the contract, the government seeks a good understanding with private parties and does not, for example, insist on imposing deductions if the contractual specifications prove to be unreasonable, if there are understandable start up problems or if shortcomings are not attributable to the contractor.

Performance of consortia not optimally monitored

The consortia's performance is not optimally monitored. The monitoring systems are very big and complex and the private party is responsible for their design and operation. The government places a great deal of trust in the monitoring systems. The trust is sometimes misplaced. We found that the systems did not work optimally on all projects and that their validity



and reliability still had to be tested in some areas. The government must be able to rely on these systems because the payments it makes are based on the monitoring results.

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Guaranteed and lump sum payments

Guaranteed availability fees were paid on the projects we audited. The government guarantees that part of the fee will always be paid even if the contractor's performance is not satisfactory. The government no longer gives such guarantees in new contracts. Furthermore, on the projects we audited the government had paid part of the contracted price as a milestone payment. The amount varied from about a third to about a sixth of the net present value of the contract.

Section 4.1 provides further details on the management mechanism and its operation.

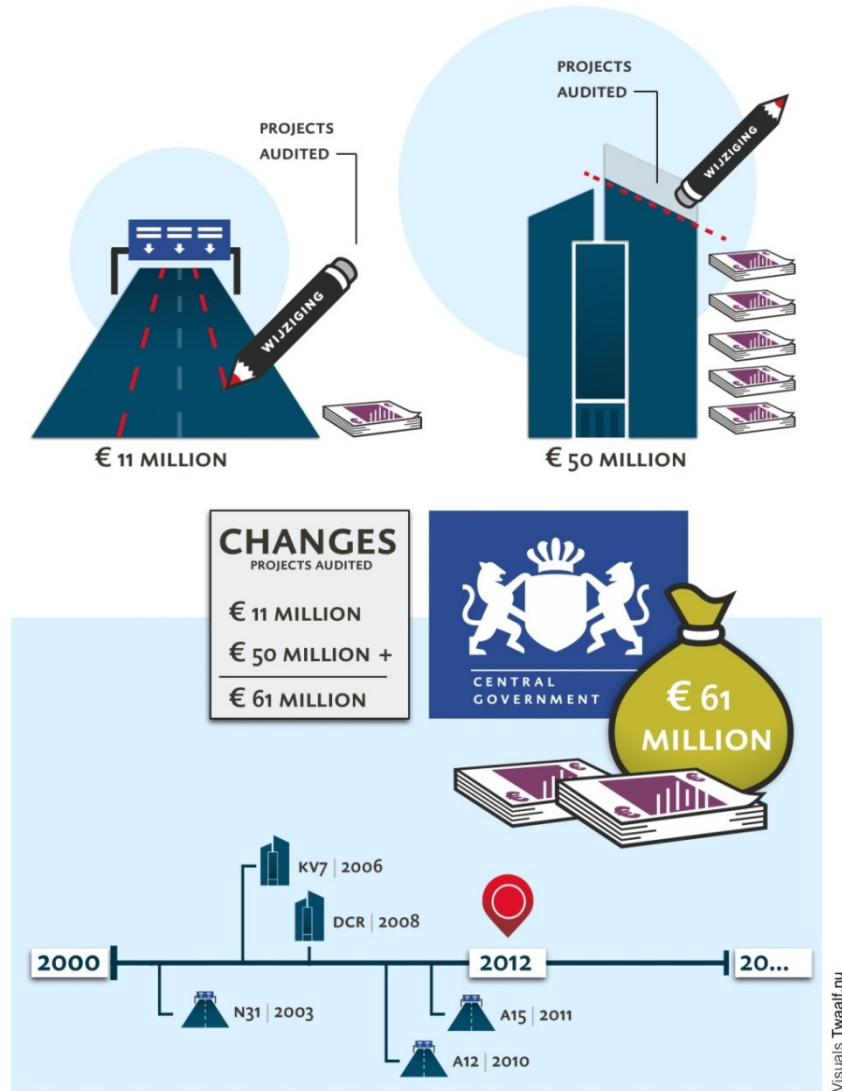
2.1.2 Changes

In a DBFMO contract the government specifies the service level it requires from the contractor but not how it must be delivered. This gives the contractor the freedom to design the project to be as efficient as possible throughout the term of the contract. If a change is requested, the contracting parties draft a change contract.

The government had requested major and minor changes in the projects we audited. Major changes were necessary because the design, in hindsight, did not suit the primary process, because the user requirements of a building had changed or because new government regulations were applicable.



Figure 3 Changes in DBFMO contracts



Changes in DBFMO contracts increase the project cost. Changes are a cause of discussion between the government and the private consortium.

In the five projects we audited, the government had concluded 157 change contracts with financial consequences. The government entered into new financial commitments in the change contracts totalling €61 million. Of this amount, €50 million related to buildings.¹⁶ Building facility services (the 'O' in the contract) are particularly sensitive to change.

¹⁶ The amount is based on project accounts. Since the accounts contained uncertainties, a conservative estimate was made using the lowest amounts disclosed.



In practice, changes regularly lead to discussion between the government and the private consortium. Strict contract management is needed to ensure that changes are dealt with correctly. The following factors play a role:

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1. The output specifications are open to interpretation because they describe 'what' must be done not 'how'. Discussions arise about whether the government is requesting a change or asking the contractor to deliver the agreed quality (What is clean?).
2. A change contract is drafted without the incentive of competition because it is difficult for the government to approach another party outside the DBFMO contract. The contract therefore states that the cost of changes must be competitive. In practice, however, the price is often not the product of market forces and its calculation is open to frequent discussion.
3. The government is subject to the DBFMO mechanism if changes are made in the contract. The cost structure therefore differs from that for separate stand-alone contracts. The DBFMO mechanism is based on the project's whole life and maintenance costs for a change are charged for the entire contract term.
4. The government also pays for the transfer of risks. If a change is made, the consortium charges the cost associated with every new risk. It will also charge administration costs and a profit mark-up. The mechanism is illustrated by the following example: if a lock is fitted to a door, the government pays for its long-term maintenance, cleaning and the risk of the lock not working or the key being misplaced.

The cost of changes is not included in the original project budget and is added to the contractually agreed availability fee. As a result, the overall project cost is higher than budgeted. The transparency of the cost of a change should encourage discipline: sufficient information should be provided to enable the government to weigh up the financial consequences against the need for a change. In practice, however, such discipline is difficult to exercise, especially in the case of buildings, because user requirements often differ from the contractual agreements.

We found that the changes in the contracts we audited had increased project costs by €61 million. About €50 million related to government buildings and €11 million to roads. At issue, however, is whether the changes represent value for money. Changes are made in all types of contract and some would probably have been made in a traditional contract. It therefore cannot be said that the estimated added value declined by €61 million. The costs of changes in two of the contracts concluded by the Government Buildings Agency (€50 million) were



considerably higher than the financial added value calculated for them (€30 million). The need to recalculate the added value would seem self-evident. To recalculate the financial added value correctly, proper records must be kept for the project and necessary data should still be available.

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More information on changes in DBFMO contracts, the amount the government paid for changes in the projects we audited and the calculation of the cost of changes is presented in section 4.2.

2.2 Provision of information to the House of Representatives

The House of Representatives needs a clearer insight into the implementation of DBFMO contracts (section 2.2.1), of the estimated added value (section 2.2.2) and of the funds involved (section 2.2.3). The House needs this information to weigh up the advantages and disadvantages of a DBFMO contract.

2.2.1 Information on implementation

The House of Representatives receives information on DBFMO contracts chiefly in respect of compliance with the applicable policy rules on the thresholds set for the assessment of added value. Biennial progress reports provide information on how line ministries implement policy, the results of the added value test of prospective projects and on which projects are being carried out. This information, however, provides only limited insight into DBFMO projects because the House receives no information on the implementation of projects after the contract has been closed. The House also receives no information on the financial cost of changes or on income from penalties or deductions.

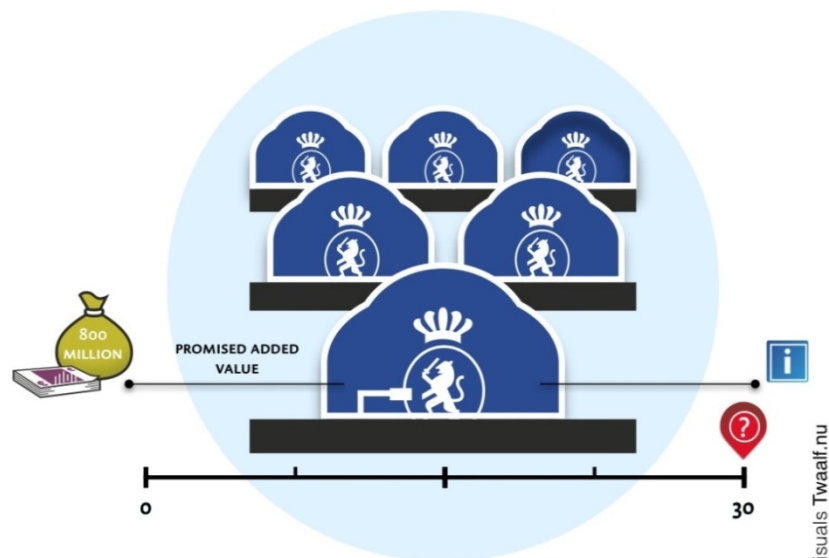


2.2.2 Information on added value

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The most striking figure in the information received by the House is the €800 million that the Minister of Finance described as actual added value (Ministry of Finance, 2012). This €800 million is based on an added value test that was used as an aid during the tendering stage.

Figure 4 Information on added value DBFMO



**THE PROMISED ADDED VALUE IS €800 MILLION.
INFORMATION RECEIVED BY THE HOUSE MUST BE IMPROVED.**

We wonder how reliable this figure is and question its disclosure and realisation (see also Netherlands Court of Audit, 2002). It was produced by mathematical models that (inevitably) work with assumptions and uncertainties. The disclosed added value of €800 million should therefore not be seen as actual added value but only as an estimate.

More information on the added value of DBFMO contracts and our reservation on the disclosed financial added value is provided in section 5.1.

2.2.3 Budgetary information

The House of Representatives has only limited insight into the longer-term budgetary flexibility of DBFMO. The customary budgeting and accounting methods are not suited to the specific nature of DBFMO. The financial commitments of a DBFMO contract continue for far longer than



the five-year budgeting and accounting cycle. The long-term commitments for DBFMO contracts therefore cannot be seen in the State balance sheet and are disclosed only partially in the government's accounts. More information is available on the commitments for infrastructure projects, carried out in the MIRT multiyear spatial planning and transport infrastructure programme, than for government buildings. The proportion of DBFMO projects to the total project portfolio (non-DBFMO) is also uncertain. Finally, the current DBFMO projects are not yet included in the EMU balance. They must be as from 2014 (see also section 5.2.3).

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Section 5.2 contains more information on the budgetary treatment of DBFMO.

2.3 Recommendations

We formulated a number of recommendations based on our findings. They relate chiefly to strengthening the organisation of DBFMO contract management. This section successively presents our recommendations to the Ministry of I&M and the Ministry of BZK, the Ministry of Finance and the House of Representatives.

2.3.1 To the Ministry of I&M and the Ministry of BZK

Invest in contract management

The new way of working with DBFMO contracts should be worked out centrally within *Rijkswaterstaat* and the Government Buildings Agency. Priority should be given to contract management. DBFMO is a new way of working and managing for both the ministries and the private consortia. A business-like approach is needed throughout the term of the contracts and the procuring authority needs appropriate substantive knowledge to balance its interests with those of the contractor.

We recommend that the line ministries and their executive agencies invest in strong and well-positioned contract management, paying attention to staff training and continuity and expertise at the executive agencies. If the government contracts out tasks, there is a risk of its own expertise being diluted. To prevent this happening, the executive agencies should constantly invest in keeping their own expertise up to standard. To manage DBFMO contracts effectively, optimal use should be made of the control mechanism (performance-related payments) and the government's interests must be protected if changes are made to the



contract. This makes challenging demands on contract management throughout the whole life of a project.

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Assess and evaluate performance

We recommend that the quality of contract management of individual projects be assessed. We think stricter assessments should in any event be made of how the government applies penalties and deductions and deals with changes. We further recommend that cross-cutting evaluations be made during the contract term of:

1. the development of project costs, including the cost of changes;
2. the quality of the consortia's systems for monitoring performance;
3. the relationship between cost and quality, including the imposition of penalties and deductions and changes in added value.

2.3.2 To the Ministry of Finance

Provide the House of Representatives with more information on the performance of DBFMO contracts

We recommend that the Ministry of Finance also provide the House of Representatives with information on the performance of DBFMO contracts. The current information is concerned chiefly with decision-making and the conclusion of DBFMO contracts. In its capacity as coordinator, the ministry could also provide information on the implementation of individual projects.

The Minister of Finance should periodically report on the implementation of ongoing DBFMO projects: Was the performance in accordance with the agreements? Was there cause for penalties or deductions and were they imposed? If not, why not? This would improve the House's information position and enable it to exercise scrutiny and make changes or intervene if DBFMO contracts were not being implemented as planned.

Independence of supervision

We recommend that the Ministry of Finance strengthen the independence of its supervision. In practice, the ministry plays several roles in DBFMO projects, from encouraging and advising on projects to overseeing policy as the body with systemic responsibility. The House of Representatives has previously called on the Minister of Finance to strengthen his supervisory role. We agree with it.

Review the added value tests

We recommend that the Ministry of Finance have the added value tests – the Public-Private Comparator and the Public Sector Comparator – be reviewed by an independent body. The added value tests are very



complex and, being confidential, are not transparent to the House. They are confidential because they contain sensitive information. The results of the tests, however, have major consequences because all subsequent contracting decisions are based on them and they are used to calculate the financial added value. The review of the added value tests should be part of a wider periodic review of DBFMO policy.

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Provide budgetary information

We recommend that the Ministry of Finance provide budgetary information in the DBFMO progress reports, in any event on the financial importance of the growing DBFMO portfolio and on the related availability fee.

2.3.3 To the House of Representatives

Reconsider the House's role and the information provided on DBFMO contracts

We recommend that the House of Representatives be informed of the specific characteristics of DBFMO and the consequences for its own role. Now that DBFMO has established itself in the government's procurement policy, the House should receive full information on the performance of the contracts, including information on the estimated and actual added value, with allowances being made for the confidential nature of the information. What does the confidentiality of certain information (added value calculation, added value percentage and contract value of government buildings) mean to the House's role?

The House can make use of the 1993 Policy Framework for the Private Funding of Infrastructure as it includes guidance on the House's role in DBFMO projects. The Large Project Programme also offers useful guidance to define the House's position and recalibrate the provision of information.



3 Response of the ministers and the Court of Audit's afterword

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3.1 Response of the ministers

The Minister of Finance responded to our draft report on 23 May 2013. The Minister for Housing and the Central Government Sector responded on behalf of himself and the Government Buildings Agency on 22 May 2013. We received a response to our draft report from the Minister of Infrastructure and the Environment – also on behalf of *Rijkswaterstaat* – on 28 May. A summary of their responses is provided below. The full texts can be found on our website at www.rekenkamer.nl.

3.1.1 Minister of Finance

The Minister of Finance wrote that our report contained useful information on how to improve contract management on DBFMO projects. He will inform the House of Representatives of the potential improvements in his next progress report. The minister highlighted the need for greater transparency in both DBFMO and traditional contract forms. Furthermore, the government opted for a DBFMO contract only if it represented value for money. Whether a project should be included in the EMU balance or not did not influence the decision. The central government budget had to cover the whole life costs of every project. In response to our recommendations, the minister gave the following undertakings to improve the provision of information to the House of Representatives. In future progress reports the minister will also include:

1. A report on performance during the operation phase, for example on the outputs achieved. The number of fines and deductions will also be disclosed. The minister believes performance (in the form of, e.g., outputs and changes) should also be compared with the performance of traditional contracts during the operation phase.
2. Lessons learned from the steps ministers take to improve contract management.
3. The size of the DBFMO portfolio relative to the associated availability fees.

The Minister of Finance would have an external party periodically check the applicable input data and estimates of added value. He would present



the results in the next progress report. The minister wrote that he was already implementing our recommendation to strengthen the independence of supervision. Within the ministry, tasks and information provision had already been segregated. The participants in a DBFMO project ('without interference or consultation') were not the same parties as the supervisors of the project. In the minister's opinion, it was also important for the effective supervision of DBFMO projects to remain abreast of the latest knowledge and understandings in the field. His civil servants therefore took part in projects, for example as advisers.

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3.1.2 Minister for Housing and the Central Government Sector

The Minister for Housing and the Central Government Sector thought our report supported the improvements already being made in contract management at the Government Buildings Agency. The minister pointed out, though, that we had audited the first projects to be implemented and therefore had no insight into the improvements that had already been made. The minister agreed with our findings. However, he thought they applied in equal measure to more traditional forms of contracting. Changes, for example, were seen to be relatively expensive in DBFMO contracts but such costs were also incurred on traditional contracts. The minister nevertheless acknowledged that the Government Buildings Agency was taking measures to improve the management of change costs in the future.

With regard to our recommendations, the minister wrote that contract management had already been strengthened and centralised within the Government Buildings Agency. Contract management was also taken into account during the project definition and tendering phases. Lessons learned during the operation phase were being applied more often to make improvements. An evaluation method had also been developed in response to our recommendations. The minister would use it to evaluate the renovation of the Ministry of Finance. He would also use it periodically and repeatedly on other projects.

Regarding the management of changes and their costs, the minister wrote that the Government Buildings Agency was advising much more forcefully on whether a change was desirable in the light of the portfolio. It would also provide more targeted advice on tendering and the competitiveness of bids. The Agency would discourage users from requesting changes that were not directly related to changes in legislation and regulations. Buildings managed under traditional (non-DBFMO) contracts would be selected as reference points for changes. This revised



approach will be used on new projects from the start of the operation phase and would also be introduced on existing projects in the longer term.

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3.1.3 Minister of Infrastructure and the Environment

The Minister of I&M agreed with the importance of further professionalisation of contract management. She highlighted the need to link professional contract management specifically to the realization of added value over the whole life of the contract. The government's interests rested on a good balance between the added value of a long-term contract and the required flexibility to make changes. The minister would like to see a sharper distinction between DBFMO in the field of infrastructure and in the field of buildings. In the field of infrastructure, public private partnerships were used only in the case of DBFM contracts. The Minister of I&M accepted our recommendations and would apply them not only during the further development of DBFMO but also in other contract forms.

The Minister of I&M wrote that contracts were continuously developing and their management was also a learning process. *Rijkswaterstaat* was learning from the experiences gained outside the Netherlands and from the evaluations and audits that had been carried out. Furthermore, contract management had been given greater priority within *Rijkswaterstaat* since 1 April 2013. *Rijkswaterstaat* was studying best practices in order to standardise its contract management processes. It had taken several measures in recent years to strengthen contract management on DBFMO projects. It had, for example, tightened up its recording of changes in scope, increased transparency and centralised knowledge and expertise.

In response to our conclusion that central government did not always impose fines and deductions, the minister acknowledged that fines were not a goal in themselves. Professional contract management, according to the minister, was hard on attributable shortcomings but fostered a long-term commercial relationship without automatically waiving fines if the shortcomings were not attributable. The minister thought our analysis should have given greater prominence to the distinction between attributable and non-attributable shortcomings. The Minister of I&M agreed with our conclusion that changes led to discussions between central government and the private consortium. In the minister's opinion, *Rijkswaterstaat* was learning from its experiences with ongoing contracts. The minister wrote that reports and accounts were already containing



more information on policy and that its implementation would be evaluated. If the output did not agree with the estimate, the discrepancy would be explained, as was the case for any other budget article. The minister was willing to consult the House of Representatives regarding its need for information in addition to that provided by existing instruments (wider than just the focus on fines and deductions) so that it could evaluate policy and its implementation.

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3.2 Court of Audit's afterword

We are pleased that our report provided ideas to improve the performance of both DBFMO and more traditional projects. DBFMO is a new way of working and managing that requires a new management culture from both the ministries and the private consortia. Strong contract management is essential, based on a professional and consistent approach over the whole contract life with the government having sufficient substantive knowledge to keep its interests in balance with those of the private contractor.

We accordingly welcome the improvement measures proposed by the three ministers. The Minister of Finance has undertaken to have the added value calculations periodically reviewed. He will also improve the transparency of traditional contract forms and of the progress reports submitted to the House of Representatives. In addition to information on the implementation of DBFMO projects, the budgetary information will be increased. We will follow the progress reports with interest. The information, including changes over time, should be presented and explained in a coherent and consistent manner. The Minister of Finance also responded to our recommendation to strengthen the independence of the supervision of DBFMO projects within the ministry. He wrote that tasks and the provision of information had already been segregated more clearly. During our audit, however, we were unable to establish the results of this supervision. There were no evaluations or broadly based reviews of DBFMO policy. We suggest that having such evaluations and reviews carried out and informing the House of Representatives of them where possible would considerably improve the visibility of the minister's supervision.

The Minister for Housing and the Central Government Sector wrote that he would strengthen the Government Buildings Agency's contract management and control of the associated costs. We will monitor the follow-up with interest. He notes in his response that changes also occur



in traditional contracts. In our opinion, the benefit of a DBFMO contract is that change costs are calculated over the project's whole life cycle. However, DBFMO promises that changes can be better managed than under traditional contracts. We found, though, that this was not yet the case in practice, especially at the government buildings we audited, where the number of changes was relatively high. We are therefore looking forward with interest to the implementation of the measures to improve contract management for changes. 24

The Minister of I&M observed that professional contract management was hard on attributable shortcomings but fostered a long-term commercial relationship without automatically waiving fines if the shortcomings were not attributable. We agree with her position and look forward to seeing it put into practice. The Minister of I&M also agreed to adopt our recommendations but provided little information in her response on how she would do so.

The House of Representatives needs reliable information to assess the implementation of DBFMO projects. We therefore again stress the importance of evaluations. Each project must be evaluated, with particular attention being paid to the development of costs, the quality of outputs and the relationship between cost and quality and changes in added value. Evaluations should also increase the effectiveness of the improvements made and promised in the field of contract management. Good contract management, after all, can provide greater assurance on the added value of DBFMO projects.



4 DBFMO contract management

We concluded that the government's management of DBFMO contracts needs strengthening in order to balance the public interest with the private interest. In this chapter we first consider the control mechanism and the need to optimise its use (section 4.1) and then the way in which changes are dealt with during the implementation of a project (section 4.2).

4.1 DBFMO control mechanism

DBFMO contracts are managed by means of a mechanism that links performance to payment. If the contractor does not deliver the agreed performance, the procuring authority does not pay the availability fee. This is an important financial incentive for the consortium to deliver the agreed performance. It balances the interests of the private party with those of the public party. The mechanism works as follows:

1. The output specifications in the contract define the minimum performance that a project must deliver. In the case of buildings, the specifications relate to space and facility services and in the case of infrastructure to availability and quality (section 4.1.1).
2. Monitoring systems are in place to determine whether the performance delivers the output specifications (section 4.1.2).
3. The payment mechanism imposes financial consequences if the agreed performance is not delivered (section 4.1.3).

For the management mechanism to work effectively, the financial incentive must remain in force throughout the term of the contract so that the consortium is obliged to continue delivering the performance. On the projects we audited, however, we found that the government had paid guaranteed availability fees. It had also made one-off payments of part of the contract sum (milestone fees), usually after the construction of a road or building had been completed (i.e. at the start of the operation stage). These milestone fees ranged from about a third to about a sixth of the net present value of the contracts.



The government pays a guaranteed availability fee even if the contractor does not deliver the agreed performance. If a guarantee has been given, the risk surcharge in the interest rate charged by the financiers will be lower. This arrangement is no longer applied in new contracts. Instead, a milestone fee is paid after the build stage but before the road or building is handed over. These measures have been taken to facilitate the private parties' financing arrangements, particularly since the credit crunch. We think the government should strictly adhere to the principles of DBFMO and ensure that appropriate financial incentives are in place throughout the term of the contract. All payments in addition to the periodic availability fee can weaken the financial incentive to deliver the contractually agreed performance.

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Below, we outline the individual elements in the control mechanism (output specifications, monitoring and payment mechanism) and present our main findings.

4.1.1 Output specifications

DBFMO contracts do not have a traditional schedule of requirements but are based on output specifications. Output specifications summarise all the functional requirements a procuring authority seeks from a building or from infrastructure and the related facility and maintenance services. The output specifications describe only the performance that the procuring authority wants to be delivered (the 'what') and not the technical solutions (the 'how'), i.e. not a road with an asphalt surface of at least 10 cm of type X but an asphalted road, and not 15 meeting rooms with associated furniture but an office with modern conference facilities.

The underlying principle is that the contractor has free rein to design and build so as to optimise the performance of an asset throughout its whole life (Government Buildings Agency, 2008). In the projects we audited, however, we found that the output specifications were still highly prescriptive and thus not entirely consistent with the principles of DBFMO. The Government Buildings Agency and *Rijkswaterstaat* recognise this and are attempting to limit the detailing of output specifications on new projects.

Another improvement made by the Government Buildings Agency is to confine the services requested on new building projects to building management services. In practice, the government is requesting fewer catering, printing, photocopying and similar services throughout the term of the contract. This gives it more freedom to benefit from the economies



of scale and shared services it already enjoys. It is still uncertain what impact this will have on the efficiency and cost of a contract as the high investment costs must be recovered during the operation stage.

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International example

The number of services procured was recently reduced in the United Kingdom. The UK has carried out DBFMO projects on a very large scale. They were evaluated in detail in 2012 and one of the main conclusions was that prescribing the services compromised the flexibility of the public sector:

"Flexibility has been a significant problem for PFI projects in the past; this will be addressed through reducing the number of services included in PFI projects. Services, such as cleaning and catering, will be excluded from the contract and provided separately through shorter term contracts in order to provide the public sector with the flexibility to alter service specifications over time" (HM Treasury UK, 2012; 10).

4.1.2 Monitoring

A monitoring system is designed to determine whether the agreed performance is actually delivered and thus set the level of the availability fee paid by the government. Monitoring systems are complex arrangements that track all the output specifications, the associated minimum quality requirements, the types of shortcomings and related recovery times and deductions.

The private party designs the monitoring system and is responsible for its performance. The government is less directly involved and must assure itself that the system is reliable, independent and functional.

In the projects we audited, we found that the monitoring systems did not always function adequately. The government had investigated the technical performance of the systems but had not reviewed their accuracy on any of the five projects we audited. It had not checked, for example, whether contractual agreements such as recovery times and deduction rates were consistent with the parameters in the monitoring system. Line ministries have specifically questioned the reliability and outputs of the monitoring systems on three of the projects. The government carried out additional checks to measure performance before making payment. On one of the projects audited, no payments had been made because it could



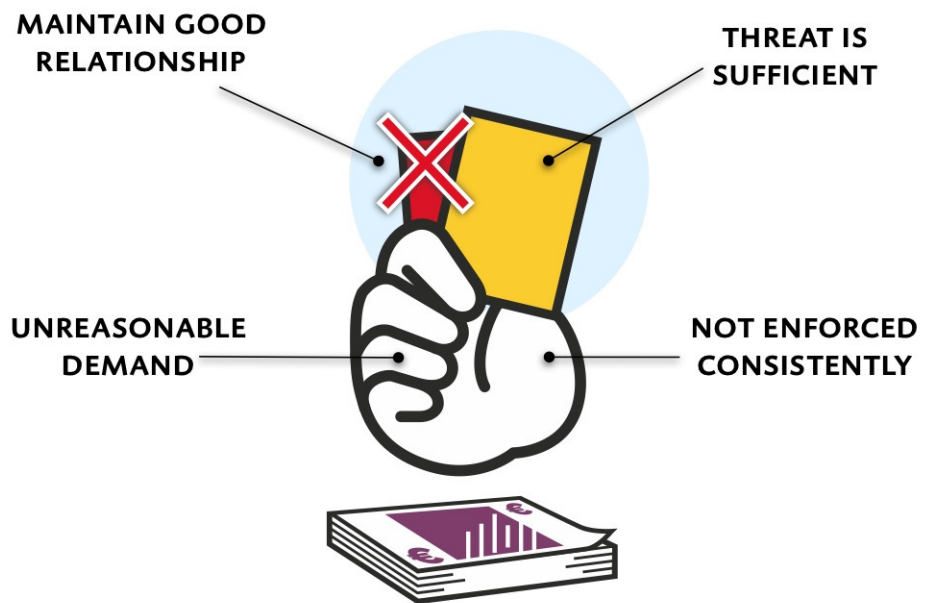
not be demonstrated that the agreed performance had actually been delivered.¹⁷

4.1.3 Payment mechanism

In a DBFMO contract, the procuring authority pays a periodic availability fee from the moment the asset is handed over until the end of the contract. If the building or road is not fully available, a deduction is made from the fee. Furthermore, DBFMO contracts include performance-related charges or the option to impose fines if the performance repeatedly fails to meet the requirements.

This payment mechanism was clearly defined in the contracts we audited. The greater part of the payments were also linked to the performance delivered. The penalty and deduction regime agreed in the contracts, however, was not always enforced.

Figure 5 Fines and deductions



Visuals Twaalf.nu

FINES AND DEDUCTIONS ARE NOT ALWAYS IMPOSED

¹⁷ Supreme audit institutions in other countries have also found similar monitoring problems . See, for example: Auditor General of Nova Scotia (2010), Auditor General of Quebec (2009), National Audit Office UK (2009), Office of the State Comptroller New York (2002).



The contractors enter into talks with the government, particularly if the deductions are high, to discuss, for example, the attribution of shortcomings or the relationship between the shortcoming and the level of the deduction. We found that these discussions could lead to the deduction being reduced, suspended or waived.

According to *Rijkswaterstaat* and the Government Buildings Agency suspending or waiving deductions is a good way to obtain the required service level without souring the relationship. In such cases, the government makes new arrangements with the consortium regarding, for example, structural solutions to prevent reoccurrence of the shortcoming. The deduction is sometimes waived with a view to settling another discussion. This is referred to as 'negotiating in the spirit of the contract'.

When the first payments are made to the consortium, the National Audit Authority (*Auditdienst Rijk, ADR*) checks their regularity. It does not check all payments because the periodic payments are too low to be included in its sample. It did check the regularity of the substantial one-off milestone payments. It found no irregularities but was critical of the contract management.

Examples of discussions of sanctions (with different outcomes)

Buildings

A pane of glass in a glass partition wall was broken and the contractor improvised a makeshift solution. The pane had unusual dimensions and a replacement had to be ordered. Since the makeshift solution did not meet the quality requirements and the shortcoming was not rectified within the permitted recovery time, the deduction mechanism came into play. The replacement pane of glass took a long time to arrive and the deduction rose. The consortium thought a deduction was not justified because the makeshift solution meant the space was functionally available. The government argued that the agreed performance had not been delivered. The contractor had opted for a glass partition wall and was therefore responsible for the risk of a broken pane. The consortium ultimately bore the cost.

Infrastructure

Several incidents occurred on a stretch of road during a three-month period in respect of which the procuring authority could recognise 40 penalty points, each representing a deduction of €5,000. To impose a deduction, any shortcoming must be attributable to the contractor, for example if one of its employees has made a mistake, signage is incorrect or lighting malfunctions. The consortium argued that the shortcomings were not attributable to it and that the problems had been quickly rectified. The government accepted its position, as permitted under the contract, and did not attach financial consequences to the incidents.



4.2 Changes during project implementation

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The parties in a DBFMO project must be able to deal with changes as they are inevitable in a contract with a term of between 25 and 30 years. In DBFMO projects, every change requested must be laid down in a contract. Changes are laid down in change contracts.

We reached the following conclusions regarding changes in DBFMO contracts:

1. In the projects we audited, the government requested major and minor changes from agreed project specifications. There were 157 change contracts, under which the government entered into financial commitments totalling €61 million (section 4.2.1).
2. Changes in DBFMO contracts have a specific cost structure (section 4.2.2).
3. Changes lead to discussions between the government and the private consortium (section 4.2.3).

4.2.1 Nature and size of contract changes

In the projects we audited, the government requested major and minor changes from the agreed project specifications, chiefly because:

1. the design – in hindsight – was not fully compatible with the primary process;
2. the user requirements for a building had changed;
3. new regulations had come into effect.¹⁸

In mid-2012, 157 change contracts with financial consequences had been agreed in respect of the projects we audited. The government entered into new financial commitments in the change contracts totalling €61 million. Of this amount, €50 million related to building projects (see figure in section 2.1.2). We calculated this sum from the project accounts. We had to estimate the total cost because the accounts contained uncertainties. Our estimate is conservatively based on the lowest amounts disclosed.

We found in practice that it was customary to pay the contractor a one-off sum for changes in infrastructure projects, i.e. a one-off payment that covered both the investment costs and the costs incurred during the contract term. In building projects, the direct investment costs are paid

¹⁸ Supreme audit institutions in other countries have also noted these problems. See, for example, Auditor General of Ontario (2008), National Audit Office UK (2008, 2009), Österreichische Rechnungshof (2010). More reports can be found at www.courtsofaudit.nl/PPP.



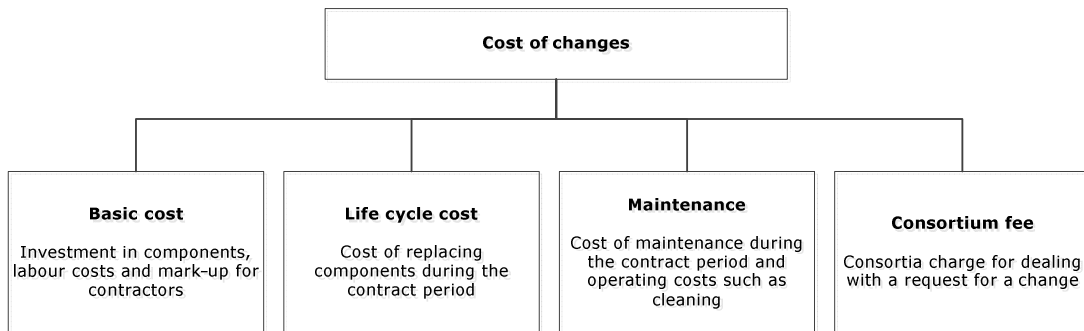
at once and additional operating costs are spread over the remaining term of the contract in the form of a higher availability fee.

Examples of contract changes
<p><i>Building (I)</i></p> <p>In the output specification for an office block, the government requested a modern open plan office space. In consequence there were few individual office rooms that could be closed with a door. Before the building was completed, the users said an open plan office space did not suit their working practices and asked for changes. Additional walls and doors were therefore fitted in the building, for which the government paid a one-off sum of €600,000 to cover investment costs and an annual payment of €19,000 during the contract term. The total cost of this change was €1,075,000.</p>
<p><i>Building (II)</i></p> <p>A waiting room was added to a detention centre, where newly arrived people had to wait during proceedings. The output specification had prescribed only a room to wait in. The room was plain and small and had a negative influence on the people waiting in it. It was therefore adapted to make the stay less unpleasant. The change cost the government €200,000.</p>
<p><i>Infrastructure</i></p> <p>Road markings had to be adapted following the introduction of new regulations. The government asked the contractor to change them accordingly. The cost to the government was about €70,000 (excluding VAT).</p>

4.2.2 Cost of changes

The cost structure of changes in a DBFMO contract consists of several elements (see figure below).

Figure 6 Cost structure of changes in a DBFMO contract





Example of DBFMO cost calculation

Fitting one lock on one door cost the government €340 in direct investment costs and €100 per annum during the contract term (in total €2,250, excluding VAT). This example includes the cost of replacing the lock at the end of its life, maintenance, key management and the amendment of project documents as well as the investment cost, consisting of equipment and labour. Since the government transferred the risk to the private party, the private party also charged a risk mark-up. The contractor is also entitled to a profit mark-up. The ultimate cost of the lock is therefore far higher than the cost of just fitting it.

The government's executive agencies are in favour of the calculation of the whole life financial consequences of a change. When changes are made in a traditional project with separate contracts, only direct investment and labour costs are calculated. Replacement costs at the end of the asset's life and additional maintenance costs are not calculated. Separate contracts do not include a risk mark-up either because the government itself bears the risk. The profit mark-up, too, is excluded from the calculation. The transparency of the cost of a DBFMO contract can have a disciplinary effect on the users. Since the procuring authority is aware of all the costs, it must consider the consequences of changes very carefully.

The contract managers on the projects we audited, however, reported that cost transparency did not bring enough discipline. In practice, the public interest or the wishes of the building users were not always consistent with the contractual agreements.

Example of a discussion of the cost of changes

The square in front of the Ministry of Finance was fenced off during the weekend. Senior politicians at the ministry wanted the public to have access to the square in the weekends and the fence has been opened every day since 2010. The cost of this change was high, chiefly because of the risk premium charged by the consortium. The government thought the cost charged by the consortium, €1 million, was not realistic. The cost is still under discussion and the government is waiting for a new proposal from the consortium.

4.2.3 Discussion of changes

Changes and their cost are a source of discussion between the government and contractors. The discussions are usually concerned with who must pay the cost of a change and how much has to be paid. In principle, the government pays if it makes a new request. If the consortium has made a design error or should have foreseen a problem, the consortium bears the cost.



Examples of discussions of changes (with different outcomes)

Building (I)

A building user asked whether the glass partition wall between the smoking room and a workroom could be made airtight. This was considered to be a new request and the government bore the cost (€2,500). It could, however, have been considered to be a design error.

Building (II)

A building user thought the corridors looked shabby because there were smudges on the white walls and asked for the standard of cleaning to be improved. The consortium replied that the walls had been painted with non-washable paint and the users should be more careful. A discussion followed about whether the government had approved the design and thus the type of paint on the walls or whether the consortium had chosen non-washable paint and had thus taken the risk that the walls might be difficult to clean. In the end, the walls were repainted with washable paint at the consortium's cost.

As the government is reliant on the consortium for facility services, a DBFMO contract states that the cost of changes must be based on market forces. The government may check whether the cost is competitive. We found that when such checks were made they sometimes led to a reduction in the cost estimate but not always to a reduction in the cost itself. In such cases, the government wished to retain a good relationship with the consortium.

The expert meeting we organised stressed that the government's executive agencies should have the requisite expertise regarding, for example, market prices, construction techniques and legal matters. Such expertise is necessary to monitor the private consortium's performance critically.

Example of relevant government expertise

Rijkswaterstaat inspected an aqueduct on one of the road projects we audited and found a serious shortcoming: the concrete structure above a girder was damaged. The private consortium had inspected the aqueduct but not found the damage. To rectify the shortcoming, the aqueduct had to be jacked up. The consortium bore the cost.



5 Information position of the House of Representatives

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We concluded in chapter 2 that the House of Representatives required a clearer understanding of DBFMO contracts and their long-term consequences in order to weigh up the pros and cons of DBFMO. In this chapter we consider the role of the House of Representatives in DBFMO projects and DBFMO policy. We first discuss the information on estimated added value that the House receives (section 5.1). We then consider the provision of budgetary information (section 5.2) and close by looking at the options open to the House of Representatives to increase its involvement in DBFMO projects (section 5.3).

5.1 Information on the added value of DBFMO

In the progress report for 2012, the Minister of Finance put a figure to the added value already realised on DBFMO projects. DBFMO contracts had saved the government €800 million and the added value might rise to as much as €1 billion. In 2010 the Rutte/Verhagen government made a structural cut of €50 million to the Infrastructure Fund. This was made possible by increasing the proportion of DBFMO projects and recognising 10% financial added value on each project.¹⁹

5.1.1 Added value test: PPC and PSC

There are two tests to determine whether DBFMO can generate added value: the Public-Private Comparator (PPC) and the Public Sector Comparator (PSC). A PPC is carried out when the estimated investment in a government building exceeds €25 million and that in an infrastructure project exceeds €60 million. A PSC is carried out during the subsequent tendering procedure.

¹⁹ Financial annexe to the VVD/CDA Coalition Agreement, 2010, p. 6.



PPC - Public-Private Comparator

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This measuring instrument calculates the added qualitative and quantitative value of public private partnerships in comparison with traditional contract forms. The calculation is based on life cycle costs, including the long-term cost of, for example, maintenance. The PPC estimates the added value – subject to a margin – relative to more traditional forms of contracting. The PPC produces a rough estimate because DBFMO is a complex process in which many assumptions about the distant future can be no more than speculative (Netherlands Court of Audit, 2002).

Rijkswaterstaat has carried out some 32 PPCs in the past five years and the Government Buildings Agency has carried out nine. If the PPC indicates that a public private partnership working under a DBFMO contract would be more advantageous to the government, a Public Sector Comparator is carried out to provide a more accurate calculation and to assess the bids.

PSC – Public Sector Comparator

The PSC makes a more detailed calculation of the estimated cost of the public alternative. What would the project cost if it were not carried out under a DBFMO contract but under separate contracts or under variants of integrated contracts such as a Design, Build and Maintain or a Design and Build contract? The PSC shows the total cost of the public variant during the project's entire life cycle. A ceiling price or guide price is set for the contract based on the PSC value (Ministry of Finance, 2011b).

Even if the outcome of a PPC favours a public private partnership, the government might not select a DBFMO contract but prefer to work with separate contracts for strategic reasons if a project is too complex or if DBFMO would take too much time. The Minister of Finance indicates in the biennial progress report how many PPCs have been carried out and how many projects have actually been implemented under a DBFMO contract. Twenty-eight (*Rijkswaterstaat*) and nine PPCs (Government Buildings Agency) found that DBFMO would generate added value. Of these, 24 (*Rijkswaterstaat*) and six (Government Buildings Agency) were ultimately carried out as DBFMO projects (Ministry of Finance, 2012). The progress report does not state the percentage or amount of added value for each project. An aggregated amount of €800 million is disclosed as added value, based on the PSCs carried out (Ministry of Finance, 2012).



5.1.2 Comments on the disclosure and calculation of added value

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A PSC expresses the financial added value as a percentage to indicate how much added value a DBFMO contract would generate in comparison with more traditional forms of contracting.

In the 2012 progress report, the Minister of Finance put a figure to the added value of DBFMO: DBFMO contracts had saved the government €800 million and the added value might rise to as much as €1 billion. The House of Representatives, however, had no insight into the calculation underpinning this claim. We received the calculation from the Ministry of Finance. It multiplies the contract values of the projects (some of which are confidential) by the percentage outcome of the PSC to produce the percentage added value.

Three comments can be made on this calculation:

1. The results of the added value tests depend in part on assumptions and estimates of a large number of uncertain parameters. Calculations based on such results accept the uncertainties. Important assumptions include the size and cost of risks and the discount rate applied. Furthermore, the long-term perspective (up to 30 years) does not add to the robustness of the calculations.
2. Another uncertainty lies in the lack of information on the cost of traditional contracts, the reference alternative (Ministry of Finance, 2011b²⁰). The actual management and maintenance cost of a traditional project is not always certain either.
3. Not all PSCs calculate the ultimate cost of a private variant at the end of the contract negotiations. Our audit found that in some cases the time between the final PSC and the financial close was just under a year. Evaluations of two other DBFMO projects showed that when the initial bids exceeded the ceiling set by the PSC, the procuring authority re-assumed some of the risks and withdrew services from the contract scope so that the bids remained under the ceiling.

We would also note that DBFMO projects are popular with private parties, partly because they guarantee work and income over the longer term. DBFMO is also an emerging market in which companies are willing to invest in order to gain experience and thus make their future bids more competitive. This can lead to keenly priced bids. By definition, the cost of

²⁰ 'As with the PPC, the problem here is that information on the quality of the service or the product is not stated on traditional projects. The costs and quantities are specified but not the required quality. For example, it might be known what road maintenance costs, but the availability (quality) is not.'



private financing is higher than that of public financing and the transaction costs of private financing are also often higher. These higher costs are taken into account in the calculation of added value.

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An important technical aspect in the calculation of added value is the discount rate applied. The discount rate expresses the time value of money. At a discount rate of 6% per annum, €1 now will be worth €1.06 in a year's time. Over longer periods, small changes in the discount rate lead to significant changes in the present value of a future cash flow. With a high discount rate, a future cost has a low present value, which may be too optimistic. We did not audit the use of discount rates.

Separate from these comments on the calculation of added value, it cannot be determined until the end of a contract whether the added value estimated when the contract was signed will actually be realised. As the added value must be realised chiefly during the operation stage of the contract, good contract management is required by both the procuring authority and the contractor (Ministry of Finance, 2010).

The example below shows that a change can influence the calculation of a project's financial added value. If the telephone service had not been included in the original contract, the private consortium would have made a higher bid for the project as a whole. The difference between the cost of public and the private implementation would then have been lower.

Example of the relationship between a change and added value
In the first year of a detention centre's use, the government decided to withdraw the telephone service from the contract and provide the service itself and allow detainees to benefit from the preferential charges offered by the government's framework contract. Since the private consortium had taken account of the income from telephone services when bidding for the project, the government had to pay compensation for loss of income. In total, the State will have to pay about €5 million for this change.

The DBFMO progress report for 2012 informed the House of Representatives of the estimated percentage added value of all *Rijkswaterstaat's* DBFMO projects. It provided only an indication of the added value (e.g. between 0 and 5%) of some of the Government Buildings Agency's projects (Ministry of Finance, 2012). Only a few project evaluations considered the conduct of added value tests. In none of these cases was an in-depth evaluation carried out.



5.2 DBFMO budgetary information

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This section considers the financial information on DBFMO projects that the House of Representatives receives from the government budget, annual reports and progress reports (section 5.2.1). It then looks at the budget flexibility of the projects (section 5.2.1) and why it is important to the House that DBFMO contracts will be included in the EMU balance as from 2014 (section 5.2.3).

5.2.1 Financial information on projects

The House of Representatives receives information on DBFMO projects via the government budget and the ministries' annual reports (including the report on the Infrastructure Fund). It also receives a DBFMO progress report every two years from the Minister of Finance. DBFMO projects are not necessarily part of the Large Project Programme.

The ministries' annual reports and budgets do not provide a full insight into the projects and funds relating to DBFMO contracts. *Rijkswaterstaat* considers the DBFMO projects that have already been closed in its annual documents and the MIRT multiyear spatial planning and transport infrastructure programme. The budget for the next five years is disclosed in the article headed 'integrated contracts'. The length of the contracts is not disclosed directly.

The budget for government buildings is disclosed for the next five years only. The information provided, furthermore, is fragmented. The Government Buildings Agency's annual documents disclose income and expenditure in the budget article 'PPP Projects'. Expenditure consists of payments to private consortia, and income of the payments made by the users of the buildings. The DBFMO project for the Judicial Institutions Service can be found only in the Agency's own budget, not in the annual accounts of the Minister.

The House receives no information on the financial consequences of changes or on income in the form of penalties and discounts.

5.2.2 Budget flexibility

The long-term commitments the government assumes on a DBFMO project have consequences for the flexibility of the ministries' budgets. The Minister of Finance has prepared budget rules for public private partnerships. In the cash accounting system, expenditure on DBFMO



projects must be recognised neutrally in multiyear budgets for availability fees. The expenditure ceiling for the initial year must also be lowered by the total sum of all expected project expenditure throughout the term of the contract. This prevents the favourable cash cycle of a DBFMO contract (receive now, pay later) influencing a ministry's decision to carry out a project under a DBFMO contract (Ministry of Finance, 1999).

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A permitted expenditure ceiling is in place in the Infrastructure Fund for availability fees. It is equal to 20% of the annual budget. The House of Representatives receives no information on the size of the total availability fees relative to the Infrastructure Fund and therefore does not know whether expenditure is approaching the 20% limit or not. The Government Buildings Agency does not have such a ceiling in the budget.

5.2.3 DBFMO and the EMU balance

The EMU balance is the balance of the government's income and expenditure. In the European Union, the EMU balance and EMU debt are the main indicators of the health of public finances.

The current DBFMO projects are not yet included in the EMU balance. Statistics Netherlands (CBS) will amend this situation in response to the stricter rules introduced by Eurostat. DBFMO projects will be included in the EMU balance as from 2014 when the national accounts are revised. For the CBS, the value of the investment is of particular importance to determine the impact of the build stage on the EMU balance. The Government Buildings Agency and *Rijkswaterstaat*, however, do not calculate this value for all projects.

5.3 Involvement of the House of Representatives in DBFMO

The Minister of Finance informs the House of Representatives about DBFMO policy. Since 2002 he has submitted a progress report on DBFMO policy and current DBFMO projects to the House every two years or so. In 2002 the report had considered public private partnerships in general but it has been dedicated in full to DBFMO since 2011.

The progress report and the government's DBFMO policy are discussed in a number of House meetings and by the standing committee on finance. The House could discuss DBFMO projects with the line ministers who fund



them from their budgets. The extent to which it does so differs from one project and one sector to another.

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Analysis of the DBFMO discussions reveals that the House has long been a supporter of DBFMO and has been calling for its wider use for some time. In 2011, the House also called for the Minister of Finance's supervision to be strengthened.

The House of Representatives is currently not involved in the conclusion of DBFMO contracts and it is not invited to scrutinise them. Guidelines were drawn up in 1993 on the House of Representatives' contribution to decision-making and negotiation of DBFMO projects. The House could instruct the Minister of Finance to have an independent body review the key features of each contract. This Policy Framework for Private Funding of Infrastructure is not actively applied.

Although most DBFMO projects are not classified as Large Projects, the Large Project regulations are an example of how the House could have a greater say in the use of DBFMO in government projects.



Appendix 1 Audit Methodology

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Between February and November 2012, we made a case study of five projects (see appendix 2 for descriptions). The main selection criterion was that the government must have had several years' experience with the performance of the contract after the building or road had been taken into service. We selected both infrastructure projects and government building projects.

For each project in the case study, we audited:

- project files, including contracts;
- minutes of meetings;
- correspondence between the procuring authority and the contractor;
- information from performance monitoring systems.

We also interviewed the contract managers responsible for day-to-day performance of the contracts.

In addition to the case study, we gained an understanding of the information provided to the House of Representatives on DBFMO and held talks with:

- policy officers at the Ministry of Finance, *Rijkswaterstaat* and the Government Buildings Agency;
- representatives of private parties.

In November 2012, the Court of Audit hosted a conference on the DBFMO model for SAIs throughout the world. More than 50 countries shared their experiences at the conference. More information on the conference can be found at www.courtsofaudit.nl/PPP.

In January 2013, we organised an expert meeting attended by all persons and organisations we interviewed for our audit. The participants discussed the steps that could and should be taken to improve the implementation of DBFMO projects. An impression of the meeting can be found at www.rekenkamer.nl.



Appendix 2 Projects audited

1. INFRASTRUCTURE

We audited three road infrastructure projects:

1. N31 Nijega-Leeuwarden
2. A12 motorway Lunetten-Veenendaal
3. A15 motorway Maasvlakte-Vaanplein

Rijkswaterstaat was the procuring authority for these projects and was also responsible for day-to-day contract management.

N31 Nijega-Leeuwarden

The N31 project was one of the first road projects to be carried out under a DBFM contract. The project entailed the doubling of the N31 over a length of 13 kilometres, the construction of the Langdeel aqueduct, new access roads at Hemriksein and Garijp, the construction of the new Fonejacht bridge and the operation and maintenance of the original and the new road. The contract had a term of 15 years after the road was taken into service. The contract value was €151.5 million, excluding VAT, discounted to 2002. The contractor was the Wâldwei consortium (www.waldwei.com).

Time line

Date	Event
2000	Decision to carry out the project as a DBFM project
2003	Contract close
2005	Provisional availability certificate issued
2007	Availability certificate issued
2022	End of contract term

A12 Lunetten-Veenendaal

The project entailed the widening of the motorway over 30 kilometres, the renewal and construction of flyovers and underpasses, the construction of two ecoducts and other fauna passages, culverts and noise barriers, dynamic traffic management (automated real-time measures to regulate traffic circulation), public lighting and management and maintenance of the original and the new road from 2011 to 2032. The contractor was the Poort van Bunnik consortium (www.poortvanbunnik.nl). The contract value was €260 million, excluding VAT, discounted to 2010.



Time line

Date	Event
2010	Contract close
2011	Additional lanes completed on part of section
1 March 2013	Work completed
2032	End of contract term

A15 Maasvlakte-Vaanplein

The project entailed the widening of the A15 between Maasvlakte and Vaanplein and the construction of a new Botlek bridge. The contract also included the maintenance of the existing infrastructure during the construction of the new infrastructure. The contract value was approximately €1.2 billion, excluding VAT, discounted to 2011. The contractor was the A-lanes A15 consortium (www.verbreidinga15.nl).

Time line

Date	Event
2011	Contract close
2011	Start of work
30 April 2015	Work completed
2035	End of contract term

2. BUILDINGS

We audited two government building projects:

1. The renovation of the Ministry of Finance
2. Rotterdam detention centre

The Government Buildings Agency was in charge of the contracting stage, during which it worked closely with the future users of the buildings. After the buildings were taken into use, the users were responsible for day-to-day contract management. In the projects audited, the users were the Ministry of Finance and the Judicial Institutions Service of the Ministry of Security and Justice respectively.

Renovation of the Ministry of Finance

The renovation of the Ministry of Finance in The Hague was the first government building project in the Netherlands to be carried out as a DBFMO project. It entailed the renovation of 66,000 m² of office space. The contract term was 25 years as from the office space becoming available. The contract value was €173 million, excluding VAT, discounted



to 2006. The contractor was the Safire consortium
 (www.strukton.nl/Projects/Renovatie-ministerie-van-Financien).

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Time line

Date	Event
2003	Decision to carry out the project as a DBFMO project
2006	Contract close
2008	Availability certificate issued
2033	End of contract term

Rotterdam detention centre

This project entailed the construction of a new detention centre on the site of Rotterdam The Hague Airport. The detention centre has space for up to 640 detainees. The project entailed the design and build of about 95 workplaces, 210 parking bays and 50 cycle parking spaces. The contract had a term of 25 years as from the facilities becoming available. The contract value was €100 million, excluding VAT, discounted to 2008. The contractor was the DC16 consortium.

Time line

Date	Event
2004	Decision to carry out the project as a DBFMO project
2008	Contract finalised
2010	Availability certificate issued
2035	End of contract term



Appendix 3 Abbreviations and definitions

Availability certificate	Written confirmation from the contractor to the procuring authority that the road or building is available for use. Payment of the availability fee usually commences once the certificate is issued.
Availability fee	Periodic payment made by the public party (government) to the private party in a DBFMO agreement for the availability of infrastructure or a building. The availability fee may be lowered by penalties or deductions.
BZK	Ministry of the Interior and Kingdom Relations
Change contracts	Separate contracts for changes in the original project contract. The original DBFMO contract remains in force.
Contract close	The moment at which the State and the private consortium sign the contract.
DBFMO	Design, Build, Finance, Maintain and Operate. A form of integrated contract.
Deduction	A reduction of the availability fee if the infrastructure or a building is not fully available.
Discount rate	A means to calculate the current value (net present value) of future income.
DJI	Judicial Institutions Service
EMU balance	The difference between the public sector's income and expenditure (central government, local authorities and social funds) in a given country and in a given year, as defined by European accounting rules.
Eurostat	Statistical office of the European Union.
Financial added value in euros	The difference in cost between a public alternative and a private consortium's bid, calculated by means of an added value test, a PPC or PSC.
Financial Close	The moment at which the banks and consortium sign the financial agreement, usually several months after contract close.



I&M	Ministry of Infrastructure and the Environment	46
KV7	Korte Voorhout 7, address of the Ministry of Finance	
Life cycle principle	An overarching approach to all stages in a project; design, build and maintain.	
MIRT	Multiyear spatial planning and transport infrastructure programme	
NPV – Net present value	Method to compare financial amounts over different years. An expenditure of €1 in 2008 is not comparable with an expenditure of €1 in 2033. To take account of this, expenditure is increased with the forecast annual rate of inflation and then discounted to present value. Key factors are the market rate of interest and a mark-up for risks.	
Penalty / penalty points	Reduction of the availability fee paid by the procuring authority to the contractor. Penalty points are based on shortcomings attributable to the contractor, for example in the field of security and process control.	
Percentage added value	Percentage difference in value between a public alternative and a private consortium's bid, calculated by means of an added value test, a PPC or PSC	
PFI projects	Private Finance Initiative projects (alternative term for DBFMO projects)	
PPC – Public-Private Comparator	Method to compare contract forms in order to select the most favourable alternative. The PPC produces a financial and qualitative comparison of the public implementation and the public private implementation (for example under a DBFMO contract) over the required life of a project.	
Private consortium	Temporary private legal person made up of private parties established to carry out the project. In a DBFMO Project, the parties include architects, building companies, facility service providers and banks.	
PSC – Public Sector Comparator	Method to compare total costs over the whole life of the project to determine whether a public private partnership could carry out the project more advantageously	



	than the public alternative	47
Public alternative	Situation in which the government carries out all parts of a project itself.	
RGD	Government Buildings Agency	
RWS	Rijkswaterstaat, executive agency of the Ministry of Infrastructure and the Environment	
Transaction costs	Costs incurred for the preparation, tendering and contract management on both the public and the private side	
Value for money	International term for economy, efficiency and effectiveness of operations.	



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Cover

Design: Corps Ontwerpers, The Hague
Photo: iStock

The Hague, June 2013