VICTORIA

Victorian
Auditor-General

The New Royal Women's Hospital —a public private partnership

Ordered to be printed

VICTORIAN
GOVERNMENT PRINTER
June 2008

PP No 114, Session 2006-08

ISBN 1 921060 78 6

VAGO

Victorian Auditor-General's Office

Auditing in the Public Interest

The Hon. Robert Smith MLC
President
Legislative Council
Parliament House
Melbourne

The Hon. Jenny Lindell MP
Speaker
Legislative Assembly
Parliament House
Melbourne

Dear Presiding Officers

Under the provisions of section 16AB of the *Audit Act 1994*, I transmit my report *The New Royal Women's Hospital—a public private partnership.*

Yours faithfully

DR PETER FROST
Acting Auditor-General

25 June, 2008

Foreword

Over the last decade, previous governments have commissioned planning studies to replace the existing Royal Women's Hospital in Carlton with a new clinical facility for Victorian women and their babies.

The newly-built hospital in Parkville has been procured by contracting the private sector, under the *Partnerships Victoria* framework, to design, build, finance and maintain the facility for 25 years from mid-June 2008 onwards.

The planning and business case for the new facility was sound, and the procurement exercise was conducted in compliance with the rules, policy and guidance set by the Government of Victoria. The government was provided with detailed analyses of both the options to replace the existing hospital, and the procurement strategies to achieve those options.

Although the difference between the final private sector bid and the state's own cost estimate was very small, there is potential for other efficiencies and value to be generated by this Public Private Partnership over the life of the contract.

A functional and flexible design, improved aesthetics, superior environmental performance, documented performance levels for non-clinical service delivery, and certainty of funding to properly maintain the new hospital, are examples of some of the positive outputs provided by this arrangement.

I encourage the Department of Human Services to complete the development of its contract management systems and processes for the new hospital. This will give greater assurance that the state will receive expected levels of service over the life of this lengthy contract with the private sector.

DR PETER FROST
Acting Auditor-General

25 June, 2008

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1.1 Introduction

1.1.1 Background

A redevelopment of the existing Royal Women's Hospital (RWH) in Carlton has been under consideration for at least a decade.

In October 2003 the State Government of Victoria announced the construction of a new RWH, to be located on a site next to the Royal Melbourne Hospital in Parkville. The building was to accommodate the RWH, Frances Perry House (a co-located private hospital), consulting suites and teaching and research facilities for medical clinicians.

The new hospital is intended to be one of the southern hemisphere's leading women's hospitals, delivering accessible, effective and high quality services to Victorian women and their newborn babies.

The hospital redevelopment has been procured and delivered as a public private partnership (PPP) in accordance with the state's *Partnerships Victoria* framework.[1]

The *Partnerships Victoria* procurement model involves a partnership between a private sector consortium responsible for design, building, financing, and maintenance. The public sector has full responsibility for the clinical services within the hospital.

The government committed $250 million in capital funds to the redevelopment of the new hospital, with $60 million of those funds originally expected to be provided from the disposal of the existing RWH property assets after commissioning of the new hospital.

Over the 25 year operating phase of the contract—which commences after construction of the facility is complete and the hospital is commissioned—the state will make total payments of $1 073 million in nominal terms to the private sector project company. According to the 2006–07 RWH annual report, this was equivalent to $421.5 million in net present value terms at 30 June 2007.

[1] Published at <www.partnerships.vic.gov.au>.

1.2 Findings from this audit

1.2.1 Adequacy of investment planning

The investment planning for the new hospital was thorough and sound.

The investment planning included detailed analysis of a defined service need, evidenced by the following key documents:

- feasibility study
- investment evaluation
- business case
- Gateway Reviews.

In summary, the documentation and advice showed:

- transparent analysis of options—including procurement options—as well as risk, project management, and governance issues
- evidence that government was provided with comprehensive information at each major decision point or milestone in the investment planning for the RWH redevelopment project.

1.2.2 Assessing value offered by the private sector bids

The framework used to assess the private sector bids was adequate. Evaluation plans were prepared at both the expression of interest and project brief stage, with identified evaluation criteria used to assess the bids.

An appropriate evaluation framework, incorporating a value for money approach, was in place to evaluate the bids.

Effective tools were developed to help assess value for money, including the Public Sector Comparator (PSC), which was one of a range of assessment tools used during the procurement process. The net present cost (NPC) of the bids was compared to the PSC in order to determine whether the project, if conducted under a *Partnerships Victoria* structure, could deliver value for money (i.e., the NPC of the bids is less than the PSC).

Other qualitative value for money tests were also applied during the procurement evaluation.

A preliminary PSC was developed in March 2003 (investment evaluation report) and again in September 2003 (business case) before the commencement of the procurement process. The final PSC was completed in April 2005 at contractual close.

Documentation relating to all of the required procurement milestones was available and requirements were conducted in line with *Partnerships Victoria* guidelines.

In particular, the following was observed:

- a PSC was constructed and updated throughout the evaluation process
- an output specification was produced (in the form of the project brief)
- appropriate sign-offs were sought and required approvals were obtained
- the evaluation of the bids were undertaken against previously determined criteria stipulated in the evaluation plan.

The State conducted a competitive tender process to identify the preferred private sector consortium to deliver the RWH redevelopment, and the procurement approach complied with the expected elements of VGPB policy and guidance, and the *Partnerships Victoria* guidelines.

1.2.3 Supervision of delivery of infrastructure and services

The construction phase of the project has been effectively managed, with appropriate governance structures in place, in accord with the requirements set out in the project agreement.

The documented processes and procedures in place for the design and construction phase provided a sound basis for the management of the project.

Importantly, the project will be completed on time and was ready for handover on 12 June 2008, with full commissioning of the hospital to occur by 22 June 2008.

The move from the current site to the new hospital appears to have been well planned and has involved all the necessary parties participating in the planning, management and monitoring of the transition.

At the time of the audit the operational (service delivery) phase of the project agreement had not commenced.

Many aspects of the contract management systems and processes for the operating phase are still under development and need to be completed as a matter of priority by the Department of Human Services. This will provide greater assurance that the expected level of service delivery by the private sector party can be measured and managed by the state.

1.3 Recommendations

The Department of Human Services should:

- fully document the processes designed to manage, monitor and review the performance monitoring program and the abatement process prior to the commencement of the operating phase **(Recommendation 5.1)**
- expedite its consideration and approval of the formal establishment of a contract management unit. This unit should be adequately resourced to ensure an effective contract management function is performed during the operating phase. **(Recommendation 5.2)**

- complete and endorse the Contract Administration Manual as a matter of urgency to supplement the Policy and Procedures Manual prepared by the project company. **(Recommendation 5.3)**

RESPONSE provided by Secretary, Department of Human Services

Recommendation 5.1

DHS is pleased to confirm the Performance Monitoring Program was formally endorsed on 2 June 2008 for implementation prior to commencement of the operating phase, consistent with VAGO's recommendation.

DHS notes the process for managing, monitoring and reviewing the Performance Monitoring Program (PMP) is also referenced in the Contract Administration Manual (CAM), with this to be finalised prior to commencement—as defined by the RWH project agreement—of hospital functions on 22 June 2008.

As for the Performance Monitoring Program, DHS documentation of the abatement process—in particular management, monitoring and review—is fully complete, consistent with VAGO's recommendation.

Recommendation 5.2

Contract management for the RWH Project has been well resourced to date as evidenced by the October 2007 appointment of the RWH Contract Administrator—well in advance of the operating phase—and the March 2008 appointment of a senior contract manager to assist the RWH Contract Administrator.

Both roles during the current Design and Construction phase have supported the RWH Project Director, whom in turn has DHS accountability for contract management prior to commencement of the operating phase.

These contract management resources have and will continue to be made available by DHS through its Major Projects Unit, until such time as a standalone business unit for contract management is created.

Recommendation 5.3

DHS notes that the Partnerships Victoria Contract Management Guidelines do not provide a target date for typical CAM completion. The critical aspects identified by the guidelines for effective contract management have been established either in processes or systems, or are available to the RWH Project Director and the RWH Contract Administrator in various existing documents, some of which are discussed in the responses to the other recommendations.

Whereas the RWH Contract Management Plan does state that some CAM elements have a revised due date for completion of November 2008, this only refers to adapting existing documents, processes and policies into a consistent form and style that will permit eventual compilation of a CAM that is easier to use.

RESPONSE provided by Chief Executive Officer, the Women's Health Service

Thank you for your invitation to comment on the recommendations contained in the report. We have liaised with the Department of Human Services and have contributed to their response where relevant.

The Department of Treasury and Finance should:

- review the Partnerships Victoria contract management guidance in relation to Contract Management Plans and Contract Administration Manuals to ensure it is clear and unambiguous, particularly in the following areas:
  - whether a Contract Management Plan and Contract Administration Manual needs to be prepared at the design and construct and/or operating phases of the project
  - whether Contract Management Plans need to be re-submitted to government if materially amended after initial noting. **(Recommendation 5.4)**

RESPONSE provided by Secretary, Department of Treasury and Finance

DTF notes the positive findings of the report on the Royal Women's Hospital project, focusing on investment planning, procurement assessment, and project governance and oversight.

DTF also notes the recommendation pertaining to Victorian contract management guidance, and confirms that:

- *Contract Management Plans and Contract Administration Manuals need to cover both the design and construct, and the operating phases of projects.*
- *Contract Management Plans are developed to map out the process for developing Contract Administration Manuals. These documents will evolve over time as projects move through different phases.*
- *revisions to documentation resulting from this evolution do not need to be resubmitted to Government.*

DTF will review its guidance material to ensure it is clear and unambiguous in relation to the role of Contract Management Plans and Contract Administration Manuals during the design and construct, and the operating phases of a project, and the process for advising Government of any amendments to documentation.

Any revisions to guidance material will be provided as an amendment to the existing guidance material on the Partnerships Victoria website.

2 About the New Royal Women's Hospital PPP

2.1 A new hospital for women and their babies

2.1.1 Background

Redevelopment of the Royal Women's Hospital (RWH) has been under consideration for at least a decade.

The Metropolitan Hospitals Planning Board recommended the redevelopment and co-location of the RWH and the Royal Children's Hospital in 1995. The then government decided the RWH should remain on its current site and a master plan for redevelopment on that site was developed. The master plan was adopted and funded with an initial $38 million. This was subsequently extended to $64 million, of which $25 million was allocated for essential maintenance and infrastructure works at the Carlton site.

In May 2001, Women's and Children's Health (the Royal Women's and Royal Children's Hospitals were then part of the same health service) requested that the government delay the project in order to consider possible redevelopment alternatives. In response, the Royal Women's Hospital Steering Committee was set up by the government to examine redevelopment options against specified criteria encompassing functionality, design, service access and implementation.

The steering committee recommended its preferred option to the Minister for Health in April 2002, which was to co-locate a redeveloped RWH on the Royal Melbourne Hospital site. In May 2002 approval was given to proceed with a feasibility study of the preferred options, culminating in November 2002 with the government making an election commitment to fund the RWH redevelopment on the Royal Melbourne Hospital site.

An investment evaluation—which reaffirmed the preferred site and assessed the potential procurement options—was completed and considered by government in March 2003. Although no funding was specifically allocated at that time, the Minister for Health was invited to submit a business case in line with the *Partnerships Victoria* policy, at a later date.

The business case was submitted to, and endorsed by, the government in September 2003.

In October 2003 the government announced the construction of a new RWH, to be located on a site next to the Royal Melbourne Hospital in Parkville. The building was to accommodate the RWH, Frances Perry House (a co-located private hospital), consulting suites and teaching and research facilities for medical clinicians.

The new hospital is intended to be one of the southern hemisphere's leading women's hospitals, delivering accessible, effective and high quality services to Victorian women and their newborn babies.

The new hospital aims to maintain the standing of the RWH as one of Victoria's major teaching hospitals and also to become a specialist hospital providing services in areas such as gynaecology, obstetrics, neonatal intensive and special care, oncology, maternity, menopause and sexual health.

A sculpture from the existing hospital in Carlton transferred to a courtyard in the new Parkville facility.

2.1.2 Project objectives

The redevelopment of the RWH as a specialist facility dedicated to meeting the health care needs of Victorian women is consistent with the government's Victorian Women's Health and Wellbeing Strategy[1] and the Department of Human Services (DHS) Metropolitan Health Strategy.

The project is also consistent with Growing Victoria Together; a statement about the government's broad vision to 2010, which balances economic, social and environmental goals.[2] The government's vision includes: 'all Victorians have access to the highest quality health and education services all through their lives.'

As part of its commitment to addressing this goal, the government has also developed a set of priority actions to guide work in these areas. DHS has identified the priority actions that are their primary responsibility, including:

- build, improve and integrate hospitals and community health centres
- link and invest in services for mothers and children through pregnancy to age eight.

The project embodies both of these priority actions, by integrating the RWH and Royal Melbourne Hospital facilities as well as improving health services for mothers and children.

The specific objectives for the project are:

- provide a modern facility that supports the delivery of accessible, cost effective and high quality patient services to Victorian women and their babies
- provide a new facility that is operationally efficient, capable of achieving service plan targets and sustaining service levels into the future
- provide an environment that enhances patient safety and improves clinical outcomes through the provision of comprehensive tertiary care for women, improved access to emergency services, specialist inpatient services, advanced diagnostics, intensive care and specialist clinical services
- provide a facility with flexible infrastructure capable of adapting to new technologies, clinical practice changes, changes in government policy and funding arrangements
- provide appropriate facilities for (and the integration of) teaching, training and research within clinical areas and between the RWH and Royal Melbourne Hospital
- achieve a successful relocation with no interruption of the ongoing delivery of services
- procure the new RWH in a manner which delivers value for money to the State
- complete the project within the budget and other parameters agreed by government

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[1] *Victorian Women's Health and Wellbeing Strategy*, Department of Human Services (Policy Statement and Implementation Framework 2002-2006).

[2] *Growing Victoria Together*, Department of Premier and Cabinet (November 2001).

- achieve efficiencies in capital and recurrent costs for both the RWH and Royal Melbourne Hospital through the best use of jointly available resources.

2.1.3 Project scope

The approved project scope incorporated three elements:

- **enabling works**—the construction and refurbishment works on the Royal Melbourne Hospital site required to be completed to allow the occupants of the Charles Connibere Building to be relocated, so that the building could to be demolished to make way for the new RWH
- **main works**—this element relates to the construction of the new RWH in line with the functional brief, which was developed by the project team in consultation with key stakeholders. It included demolition of the Charles Connibere Building, construction of a 980-space underground car park and the main RWH building itself (incorporating a 60-bed private hospital to replace the existing Frances Perry House)
- **asset sales**—the redevelopment of the RWH on the Royal Melbourne Hospital site will enable the disposal of the existing RWH site, together with a number of other properties owned by the hospital.

2.1.4 Using the private sector to deliver the new hospital

The hospital redevelopment has been procured and delivered as a Public Private Partnership (PPP) in accordance with the State's *Partnerships Victoria* policy, which was first released in June 2000.

The *Partnerships Victoria* procurement model involves a partnership between a private sector consortium responsible for design, building, financing, and maintenance; with the public sector maintaining responsibility for provision of the clinical services within the hospital.

The Charles Connibere Building being demolished to clear the site.

Newly installed illuminated signage at the new Royal Women's Hospital in Parkville.

Contract for the delivery of infrastructure and services

A project agreement was executed in April 2005 between the State of Victoria and the Royal Women's Health Partnership Pty Ltd (the project company) that provided for the:

- finance, design and construction of the new facility—scheduled to take approximately three years—with a target completion date of June 2008
- ongoing delivery of cleaning, car parking, help desk, security and building maintenance services (the services), excluding clinical functions—for a period of 25 years, from completion of the facility to June 2033.

The project company contracted with the following consortium members:

- Baulderstone Hornibrook Pty Ltd—to design and construct the works, including procurement and installation of certain equipment
- Wilson Parking—to operate the RWH car park
- United Group Services—to provide various contracted facilities management services, except for the section of underground car parking operated by Wilson.

United Group Services entered into subcontracts with Deanmac to provide security services, and ISS Australia to provide cleaning and 'hotel' services.

2.1.5 Cost of the redevelopment

The government committed $250 million in capital funds to the redevelopment of the new hospital, with $60 million expected to be provided from the disposal of existing RWH property assets, after the commissioning of the new hospital.

This intention was detailed in the project's business case and relevant media releases, although approval for the redevelopment was not contingent on an asset sell-off. To date, no final decision has been made on whether proceeds from DHS asset sales or specifically the old RWH site will be used to fund the balance of the state's contribution of $60 million.

Over the 25-year operating phase of the contract, which commences after the construction of the facility is complete, the state will make quarterly service payments totalling $1 073 million in nominal dollar terms.[3]

The quarterly service payments represent both the capital cost of construction and costs of services delivered by the private sector over the term of the agreement.

As the majority of risks associated with the ownership of the hospital over its life are retained by the state, the value of the physical assets and the associated liabilities will be included on the state's balance sheet, when construction is complete. The liability recorded represents the present value of the state's obligation to finance the capital cost of building the facilities.

As well as the service payments to be made over the contract term, a total of $68.02 million has been budgeted for other costs related to the project and its management, such as enabling works, project management, contingency and relocation costs.

This amount has excluded some additional costs that are also related to the project but have not been included in the above budgeted costs. These costs include:

- $3.1 million for the purchase of office space at 55 Flemington Road—this cost did not form part of the business case as the need for it did not become apparent until the Royal Women's Hospital and Royal Children's Hospital split into two health services on 1 July 2004. This resulted in some of the administration functions at RWH no longer being able to be housed at the Royal Children's Hospital, thus requiring additional office space.
- other less significant costs relating to the:
  - assignment of the Frances Perry House lease
  - preparation of a business case for the car parking revenue
  - a contribution to the costs relating to the preparation of a business case for the development of a shared retail precinct with Melbourne Health.

2.1.6 Governance arrangements

In September 2003 the Government of Victoria approved the project's business case and delegated to the Treasurer and the Minister for Health responsibility for conducting the *Partnerships Victoria* procurement process, including approval of the 'expression of interest', 'project brief', final 'Public Sector Comparator', 'preferred tenderer' and the project agreement.

[3] According to the 2006–07 annual report of the RWH, this is valued at $421.5 million in net present value terms.

DHS has the lead role in supervising the redevelopment on behalf of the state.

The project's governance structure during the construction phase comprised:

- **a steering committee**—the peak project governance body that supervises delivery (time, cost and quality) of the project, accountable to the Minister for Health
- **the project control group (PCG)**—the peak project forum at which the state and the project company review the overall progress of the project. The PCG has been delegated responsibility for the planning, design, construction and commissioning of the new hospital
- **the state's project director**—responsible for managing the project on a day to day basis including taking full accountability for the project design and documentation, procurement, supervision of construction and implementation and commissioning, management of contracts, consultants and contractors and budget management and reporting.

The RWH redevelopment project is subject to review under the Gateway Review Process, managed by the Department of Treasury and Finance (DTF). The business case was reviewed (Gate 2) in September 2003 and a 'readiness for service' review (Gate 5) was performed in early 2008.

2.2 Objective and scope of this audit

The objective for this audit was to assess the adequacy of the state's planning, procurement and management of the RWH redevelopment.

This audit objective was addressed by assessing whether:

- planning for the redevelopment project was adequate and included soundly based advice and recommendations to government on project financing and procurement methods
- procurement for the redevelopment project was conducted in line with relevant policy and guidance
- the state has been adequately managing its involvement in the construction phase of the project
- arrangements established by the state, to manage and supervise the long-term role of the private sector partner in supporting the operation of the new hospital, are adequate.

The following agencies were included in this audit:

- DHS
- DTF
- RWH.

The audit was performed in accordance with the applicable Australian auditing standards for performance audits.

The total cost of this audit, including staff time, overheads and the preparation and printing of this report, was $285 000.

3 Planning for the investment in a new hospital

At a glance

Background

Formal planning for a replacement facility for the Royal Women's Hospital (RWH) has been underway since early 1999.

The objective of a public sector investment is usually to produce service outputs that achieve desired outcomes. The starting point for any investment proposal and evaluation must therefore be the identification of the service need to be addressed by the investment proposal.

Defining the service need is a critical factor of investment planning as it helps to determine capital funding priorities and whether a proposed investment will address the government's service priorities.

Key findings

- The investment planning included sound analysis of a defined service need.
- The investment planning documents:
  - are comprehensive, and overall, incorporate Department of Treasury and Finance (DTF) guidance
  - provide a transparent analysis of options, including procurement options, as well as risk, project management, and governance issues
  - provided evidence that the government was given appropriately comprehensive information at each major decision point or milestone of the RWH redevelopment project.
- The business case was constructed in line with the general principles of DTF's *Partnerships Victoria* Practitioners' Guide (June 2001), as well as DTF's Gateway Business Case Development Guidelines (August 2003).

3.1 Investment planning

3.1.1 Background

Formal planning for a replacement facility for the Royal Women's Hospital (RWH) has been underway since early 1999.

Key drivers for a redevelopment included:

- the degraded quality of infrastructure, with the existing hospital in a poor state of repair. This presented a risk associated with compliance with relevant building regulations as well as providing a poor environment for patient care.
- high recurrent costs of the current building, which—due to its age—is expensive to maintain and presents limited opportunities to generate efficiencies through shared services
- opportunities to improve services and reduce cost through integration of clinical service delivery via a proposed relocation of the RWH to a new building adjacent the Royal Melbourne Hospital.

Figure 3A provides a chronology of events in the planning of the investment in the RWH redevelopment project.

Figure 3A
Chronology of events in planning for the RWH redevelopment project

Date	Planning event
February 1999	Initial master plan for redevelopment of the RWH completed, with associated funding approved.
May 2001	Government decision taken to carry out a review of options.
March 2002	Completion of the first steering committee report to the Minister for Health recommending a full feasibility analysis on redevelopment of the existing site and re-location to the Royal Melbourne Hospital, with an investment evaluation to be undertaken for a preferred option.
April 2002	Minister for Health approves the project to proceed to feasibility study and investment evaluation phase.
November 2002	Premier commits to the rebuilding of the RWH.
January 2003	Feasibility study completed.
March 2003	Investment evaluation report presented to government.
September 2003	Business case presented to government and approved.

Source: Victorian Auditor-General's Office analysis of DHS documents.

3.1.2 Criteria

Criteria to evaluate the adequacy of investment planning for the redevelopment were based on:

- the *Partnerships Victoria* policy and guidance suite[1]
- the Gateway Review Initiative[2] and DTF's better practice lifecycle guidelines[3], with a particular focus on the project appraisal and business case development guidance.

The following questions were posed for this part of the audit:

- did the investment planning include sound evidence of a defined service need?
- did the investment planning conform to relevant policy and guidelines?

Paving being installed at the main entrance of the new hospital.

[1] <www.partnerships.vic.gov.au>.

[2] <http://www.gatewayreview.dtf.vic.gov.au/>.

[3] The guidelines are published at <http://www.dtf.vic.gov.au>.

3.2 Sound evidence of a defined service need

The objective of any public sector investment is usually to produce service outputs that achieve desired outcomes. The starting point for any investment proposal and evaluation must therefore be the identification of the service need to be addressed by the investment proposal.

Defining the service need is a critical factor of investment planning as it helps to determine capital funding priorities and whether a proposed investment will address the government's service priorities.

3.2.1 Feasibility study for the new hospital

A feasibility study for the new hospital was completed in January 2003. The study used a 'best practice model of care' for the future development of facilities for the RWH and examined the viability of the following redevelopment options:

- option W2—refurbish the existing RWH buildings
- option W4—rebuild on the existing Grattan Street site
- option M5—redevelopment adjacent to the Royal Melbourne Hospital, Parkville
- option D1—redevelopment on the former Royal Dental Hospital site, Parkville
- option G2—redevelopment on a greenfield site.

Recommendation of preferred redevelopment option

The purpose of the feasibility study was to provide a comprehensive analysis of each of the options. Although it provided information about cost and risk ratings for each option, the evaluation was predominantly undertaken against socio-economic criteria, as follows:

- model of care—the extent to which the model of care can be achieved (including improved access to intensive care and other key clinical support services)
- functionality—the extent to which an option improves functionality and efficiency and improved patient amenity (including the host hospital for co-location options)
- identity—extent to which separate identity can be assured through the design (including separate entry and privacy)
- flexibility of infrastructure—ability to be adapted as technology and demand changes
- maintenance of services—capacity to maintain hospital operations and building engineering services during construction
- teaching, training and research (TTR)—the extent to which the option can accommodate TTR requirements
- patient accessibility—geographic accessibility, particularly in relation to services for women in the inner northern and inner western suburbs and rural/regional Victoria
- public transport accessibility
- ease of navigation around the site

- layout during construction—impact on patients, visitors and staff during construction
- construction time—including capacity for staging.

The option selected—option M5—was neither the lowest cost option, before asset sales, nor the lowest risk option; the risk, however, was not significantly different from the other options.

Overall, option M5 outscored the other options in the socio-economic evaluation for the following reasons:

- the option was considered to provide the best 'fit' for the future delivery of services under the RWH model of care
- better functionality, identity, flexibility, capacity to maintain services during construction, accommodation of teaching, training and research requirements, patient accessibility and construction time
- particular disadvantages of redevelopment on the existing site included the lack of connection to an adult teaching hospital, the relatively higher level of impact of construction activities on maintaining services during construction, and the significantly longer construction timeframe associated with the refurbishment of the existing, outmoded, main tower
- the option offered the highest potential for achieving ongoing recurrent cost efficiencies through the sharing of services and infrastructure with the Royal Melbourne Hospital.

A view of the nearly completed facility from Flemington Road.

3.2.2 Investment evaluation report

Financial evaluation of the options was undertaken as part of the investment evaluation. A final conclusion on the best option based on both socio-economic and financial criteria was reserved until after the completion of the investment evaluation.

The purpose of this report was to assist DHS to determine and evaluate procurement options for the delivery of the project by:

- providing a summary analysis of the RWH redevelopment options (as documented in the feasibility study)
- making a recommendation on a preferred procurement option based on an evaluation of project risk and associated costs and benefits to the state (including examination of a *Partnerships Victoria* approach)
- identifying the potential for capital and recurrent cost savings available to the state through the co-location of the RWH and Royal Melbourne Hospital
- evaluating the risk and return of various commercial opportunities linked to the RWH project (such as car parking, retail precinct and consulting suites).

The investment evaluation report for the new hospital was presented to government in March 2003 and recommended that the preferred option was to build the new hospital at the Royal Melbourne Hospital site.

The key reasons for this decision were:

- clinical outcomes—given the age and functional deficiencies of the existing RWH facility, patient safety and services would be improved for acutely ill patients, through co-location with a general adult tertiary facility that has an adult Intensive Care Unit and associated medical support
- synergies and cost efficiencies—a number of opportunities were available to integrate both clinical and non-clinical services to improve efficiencies and annual cost savings up to $10 million
- capital funding—the relocation of the RWH to a site that is owned by the state (through Melbourne Health) would allow the disposal of the existing RWH site and a number of ancillary property assets
- retention of specialised women's health care—the proposed new RWH would deliver a 'world-class' specialist women's health care facility for Victoria. This was seen to be an extremely important outcome given the results of community consultation, which indicated that women in Melbourne and Victoria place a high value on a dedicated facility
- overall network reform—the project would facilitate the reform of the former Women's and Children's Health and Melbourne Health (MH), to achieve cost savings and a specialist focus on women's health.

Capital costs of the project

The capital costs documented in the investment evaluation report were based on those provided in the feasibility study. Figure 3B shows the total estimated project end costs for each option.

Figure 3B
Investment evaluation report estimated total project end costs (March 2003)

	Options				
Nominal $M	**M5 (co-locate with RMH)**	**W4 (re-development)**	**G2 (greenfield site)**	**D1 (former RDH site)**	**W2 (refurbish-ment)**
Royal Women's Hospital works:					
Enabling site[(a)]	17.58	0.00	0.00	4.47	0.00
Shared enabling	6.73	0.00	0.00	0.00	0.00
Central plant and infrastructure	23.26	42.79	28.56	36.52	0.00
RWH building	63.50	70.99	73.77	71.85	169.00
TTR building	3.01	7.27	3.05	3.05	0.00
Net construction cost	**114.08**	**121.05**	**105.38**	**115.89**	**169.00**
Contingencies	12.55	19.98	11.59	12.75	0.00
Total construction cost	**126.63**	**141.03**	**116.97**	**128.64**	**169.00**
Other project costs[(b)]	36.55	42.17	37.06	39.65	0.00
Total project cost	**163.18**	**183.20**	**154.03**	**168.29**	**169.00**
Escalation factor	23.11	40.48	17.82	20.76	29.00
Total RWH project end cost	**186.29**	**223.68**	**171.85**	**189.05**	**198.00**
Associated project costs:					
Frances Perry Private Hospital	23.97	0.00	23.60	23.60	0.00
Car park	27.07	3.25	27.07	27.07	0.00
Total project end cost	**237.33**	**226.93**	**222.52**	**239.72**	**198.00**
Asset/revenue sources:					
Asset disposals[(c)]	(55.58)	0.00	(55.58)	(55.58)	0.00
Asset acquisitions	0.00	0.00	40.00	20.00	0.00
Net cost to government	**181.75**	**226.93**	**206.94**	**204.14**	**198.00**

(a) Enabling works relate mainly to the decanting of the Charles Connibere Building.
(b) Other project costs relate to furniture, fittings and equipment, ICT and management fees.
(c) Asset disposal values were increased to reflect updated valuations in November 2002.
Source: Investment evaluation report, March 2003.

Analysis of procurement models

Another key consideration addressed by the investment evaluation report was the analysis of the available procurement model for the new facility. The report addressed the following options:

- design and construct model
- managing contractor model
- *Partnerships Victoria* model.

Figure 3C shows the analysis of the advantages and disadvantages of the procurement models that were reviewed as part of the investment evaluation report.

Figure 3C
Advantages and disadvantages of project procurement models

Advantages	Disadvantages
Design and Construct model	
• Potentially facilitates a shorter procurement timeframe • Separates construction and operational aspects such as maintenance	• State remains highly exposed to design risks and cost overruns • Limits focus on whole-of-life cost considerations • Requires significant upfront capital funding
Managing Contractor model	
• Open book partnership to develop final design • Transparent pricing allows DHS to make value judgements on inclusions/exclusions • Potentially faster delivery timetable given design not fully developed during tender process	• Limited focus on whole-of-life costs • Significant exposure to design changes post selection of managing contractor, which can generate costs to the state
***Partnerships Victoria* model**	
• Robust delivery model with a clear focus on risk allocation to generate value for money • Locks in high quality outcomes on a defined cost basis • No requirement for payments until operational commissioning • Provides an opportunity for private sector delivery of an expanded facility for Frances Perry House	• Potentially adds six months to the timetable • Structure of the deal/scope of services • Lack of flexibility for change • Impacts on MH's shared services business

Source: Investment evaluation report, March 2003.

The investment evaluation report also included a more detailed analysis of various potential *Partnerships Victoria* options for the RWH building works component of the project. The following four *Partnerships Victoria* options were assessed in detail:

- option 1—the private sector designs, builds, finances and maintains ('DBFM') the RWH (including the car park), upgrades the central plant for the entire site and provides only limited maintenance and other asset-specific services to the whole Royal Melbourne Hospital site
- option 2—as with option 1, but with service provision limited to RWH
- option 3—as with option 2, but with stand-alone plant for RWH only
- option 4—as with option 3, but with only basic investment in the RWH plant.

These options were analysed against the following criteria by the investment evaluation report:

- control of design, capital cost and timetable
- recurrent cost optimisation
- opportunities for risk transfer
- complexity
- potential to deliver value for money.

Based on a detailed analysis of the different procurement options the investment evaluation report recommended that a *Partnerships Victoria* procurement model, (option 2) should be adopted for the RWH building works, building the hospital at the Royal Melbourne Hospital site (option M5).

3.2.3 Development of a business case

After the investment evaluation report was presented to government, a business case based on a *Partnerships Victoria* procurement model was requested. The business case was approved by the State Government in September 2003.

The business case evolved from work contained in the feasibility study and the investment evaluation report and contained evidence of:

- defined need—as previously discussed for the feasibility study and the investment evaluation
- consideration of future growth requirements and needs—the needs of the hospital were based on the approved service profile
- economic benefit—some of the key benefits cited in the business case were:
  - provision of improved patient care and comfort, as well as a better working environment for staff via a modern, state-of-the-art facility
  - integration of services resulting in an increase in the quality of service delivery and the opportunity for significant recurrent cost savings
  - realisation of site value by leveraging the value of the Melbourne Health precinct and allow the state to release capital from RWH non-core assets
  - mitigation of the significant cost and occupational health and safety risks associated with the existing RWH facility

- access to new equipment to improve the level of healthcare services and minimise operating costs
- environmental issues as the demolition of the Charles Connibere Building and excavation for the new car park would remove any asbestos and ground contamination risks
- efficient energy usage by the requirement to meet Ecologically Sustainable Development guidelines.

The business case was a comprehensive document that incorporated the necessary information required by the *Partnerships Victoria* guidelines.

Planning for future requirements

The business case included a service profile for the redeveloped RWH. This profile was determined by a service planning review undertaken in 2001–2002 and formed the basis of a facility configuration for the new hospital. The service profile was modeled for 20 years, with the new hospital configuration based on a mid-point of projected activity in 2011.

The service review incorporated service demand modelling and a review of environmental factors including:

- RWH service delivery levels
- service demand projections
- Australian Bureau of Statistics data
- projected RWH market share after the relocation of the Mercy Hospital for Women from East Melbourne to Heidelberg in 2006.

The service review was informed by the following key documents:

- Strategic Service Plan and Model of Care for the Royal Women's Hospital—Final Report 2001
- Strategic Functional Brief Version 6—17 December 2002
- RWH Model of Care—2002–2006.

Consistent with the RWH model of care, service planning allowed for a reduction in the average length of stay for inpatients as it was anticipated that there would be a decrease in overnight stays by non-maternity patients.

The estimated 2011 service profile is shown in Figure 3D.

Figure 3D
Estimated service profile for the new hospital in 2011

RWH project service profile	Annual volume
Maternity separations (i.e., patients treated)	2 250
Deliveries	5 250
Non-delivery separations	1 000
Total multi-day separations	**8 500**
Same-day separations	11 100
Pregnancy day care centre	2 700
Total adult multi-day and same-day separations	**22 300**

Source: RWH redevelopment business case, September 2003, p. 73.

Care for complex maternity patients, who would have otherwise been admitted as inpatients, was increasingly expected to be provided as 'same day' services through the pregnancy day care centre and other ambulatory areas.

At time of service planning, birth activity at the existing RWH had declined from a peak of 6 657 births in 1996–97 to a six year low point of 4 660 in 2001–02, in large part reflecting national (declining) birth trends at that time.

Since the business case was approved (five years ago) there has been a 20 per cent increase in demand for maternity services at the RWH: from 4 660 women giving birth in the 2001–02 financial year to 6 363 women giving birth in the 2006–07 financial year (albeit still below the 1996–97 peak of 6 657).[4]

The increase in activity levels from the 2001–02 low point was particularly evident from 2003–04 (5 118 births)—an increase of 8.4 per cent from the previous year (4 721 in 2002–03). We note that this coincided with implementation by the Commonwealth Government of a 'baby bonus' payment from July 2004.

In response to increases in birth activity at RWH and other Victorian public maternity hospitals from 2004 and later periods, DHS developed the Maternity Demand Action Plan (December 2006) to manage maternity demand on a state-wide rather than site specific basis.

The RWH project brief included the requirement for the building design to provide flexibility for the potential future addition of two extra floors on the new hospital. Figure 3E discusses the future flexibility issue and the impact of an unforeseen increase in maternity demand.

[4] The Royal Women's Hospital Clinical Report 2007, page 9, figure 2, 'Number of women giving birth'.

Figure 3E
Future flexibility in design to facilitate increase in demand

During the past five years, RWH has seen a 20 per cent increase in demand for maternity services. The increase followed a six year low point in birth numbers at the RWH, in large part reflecting national birth rate trends at that time.

It has been DHS policy for a number of years to include flexibility in a project brief to design the building with the ability to accommodate future expansion. The new RWH building design incorporated an adjustable roof as well as other design features, which would allow the addition of two extra floors.

In light of the increased maternity demand, which became more obvious during construction, it would have been prudent for DHS and DTF to conduct a cost/benefit analysis of the option to add extra floors during the construction phase, as part of a possible solution to address the rise in maternity demand and other increasing pressures in the public hospital system.

However, we saw no evidence of any consideration by DHS during the construction period to exercise the design option to add extra floors. Instead, the increase in maternity demand is planned to be managed using the existing metropolitan health network, and targeted investment in hospitals located in Melbourne's growth corridors.

Building the additional floors during the initial construction would have been far more cost effective and less intrusive to the hospital's operations than expanding in the future. Any short-term savings made by avoiding expansion now, will likely be invalidated by much higher costs in the future, if a decision is made to expand the new RWH.

Source: Victorian Auditor-General's Office analysis of DHS information.

Gateway Review of the business case

The Gateway Initiative was introduced by DTF in March 2003 and reviews projects at six 'gates' in a project's lifecycle.

The RWH project started prior to the introduction of the Gateway Initiative and therefore was not subject to the 'Strategic Assessment' (Gate 1) review. It was, however, subject to the 'Business Justification' (now known as Business Case) review (Gate 2).

Issues identified in the Gate 2 review that required action were resolved prior to the business case being submitted to government for approval and prior to completion of the next applicable review, Gate 5 'Readiness for Service'. (At the time of the commencement of the RWH project, *Partnerships Victoria* projects were not required by government to undergo Gate 3 and 4 reviews).

3.2.4 Conclusion on investment planning

The investment planning included sound analysis of a defined service need, evidenced by the following:

- **Feasibility study.** The study was a comprehensive document and included information about specific requirements for the new RWH such as the model of care, schedules of accommodation, capital costs and socio-economic criteria.
- **Investment evaluation**. The evaluation report was a comprehensive document and included strategic options analysis as well as an assessment of the procurement models available for the project.

- **Business case.** Both the feasibility study and the investment evaluation provided comprehensive information on option evaluation and procurement assessment, which was reflected in the approved business case. In particular the business case:
  - was based on sound evidence available at the time of its development
  - was not amended after it was approved by the State Government in September 2003.
- **Gateway Review Process.** Issues that required actions (identified in the Gate 2 review) were resolved prior to the business case being submitted to government.

The newly fitted-out Special Care Nursery.

3.3 Conformance to guidelines

3.3.1 Conformance of the business case to DTF guidance

The business case was constructed generally in line with the principles of DTF's *Partnerships Victoria* Practitioners' Guide (June 2001), as well as DTF's Gateway Business Case Development Guidelines (August 2003), which were issued one month prior to the completion of the business case.

There are no mandatory elements in the DTF guidance; it is the responsibility of the person accountable for the program or project to determine what is required in the business case. The following elements of a business case suggested by the *Partnerships Victoria* Practitioners' Manual[5] were not included in the RWH business case:

- The business case does not discuss why the Royal Melbourne Hospital site option is preferred or the procurement models considered. However, this is documented in the investment evaluation which was presented to the government in March 2003.
- The business case does not explain why government was considered better able to manage or mitigate the retained risks. Certain risks are better managed or mitigated by government, however, the reasons for this were not addressed in the business case.
- There were a number of risks that were not quantified. Some risks are not easily quantifiable, and an overview of risk methodology and analysis of non-quantified risks was examined in depth during the development of the project Public Sector Comparator.
- The value of the land at RWH or Royal Melbourne Hospital was not mentioned in the business case. Financial consultants to DHS advised that asset sales and land re-use were not included as part of the potential *Partnerships Victoria* transaction, as the aim was to attract bidders to build a hospital and provide services for 25 years. DHS and DTF believed there was a strategic risk that if valuable, inner urban land was included, consortia with a focus on property development may enter the bidding process primarily to gain access to a right to on-sell or develop the existing RWH site.

3.3.2 Conclusion on conformance

The investment planning documents:

- are comprehensive and incorporate DTF guidance
- have some minor missing areas of analysis, but this does not invalidate the conclusions or recommendations reached
- provide a transparent analysis of options—including procurement options—as well as risk, project management, and governance issues
- showed evidence that the government was provided with comprehensive information at each major decision point or milestone of the RWH redevelopment project.

[5] Pages 20–23.

4 Assessing value offered by the private sector bids

At a glance

Background

Due to the long term nature, and usually high dollar value, of a Public Private Partnership (PPP) contract, it is critical that the value for money assessment, as well as the procurement process, is conducted effectively, and in line with relevant rules, policies and guidelines.

This provides assurance that a rigorous assessment of the private sector bids has occurred, and that the process to appoint the successful bidder is beyond reproach or challenge.

Key findings

- The State Government conducted a competitive tender process to identify the preferred private sector consortium to deliver the new Royal Women's Hospital project.
- The procurement approach complied with the expected elements of Victorian Government Purchasing Board policy and guidance and with the *Partnerships Victoria* guidelines.
- The risk allocation in the project agreement is consistent with *Partnerships Victoria* guidelines.
- Expected standards of probity were maintained and enforced.
- The final adjusted Public Sector Comparator was determined as $367.7 million with the Net Present Cost of the successful bid at financial close at $365.24 million. The bid at financial close was under the PSC, representing a cost saving for the state of $2.46 million or 0.67 per cent, over 25 years.

4.1 Assessment of value for money

4.1.1 Background

Due to the long term nature, and usually high dollar value, of a Public Private Partnership (PPP) contract, it is critical that the value for money assessment, as well as the procurement process, is conducted effectively, and in line with relevant rules, policies and guidelines.

This provides assurance that a rigorous assessment of the private sector bids has occurred, and that the process to appoint the successful bidder is beyond reproach or challenge.

4.1.2 Criteria

To determine the adequacy of the value for money assessment provided by private bidders, criteria were derived from the following *Partnerships Victoria* guidance:

- *Partnerships Victoria* Guidance Material Practitioners' Guide
- *Partnerships Victoria* Public Sector Comparator Technical Note and Supplementary Technical Note
- *Partnerships Victoria* Risk Allocation and Contractual Issues Guide
- *Partnerships Victoria* Contract Management Guide.[1]

The Victorian Government Purchasing Board (VGPB) Probity Policy was also used to assess the probity process used to monitor the procurement process.

So that an adequate assessment of the value for money provided by private sector bids could be completed the audit posed the following key questions:

- Were effective tools developed to help assess value for money?
- Did the procurement process follow the rules and guidelines?

[1] <www.partnerships.vic.gov.au>.

4.2 Tools to assess value for money

4.2.1 Framework and approach used to assess bids

Figure 4A provides a diagrammatic representation of the procurement process used for the new Royal Women's Hospital (RWH).

Expressions of interest (EOI)

An EOI evaluation process was created to short list the four respondents who submitted an EOI. The short listed candidates were then invited to submit a 'Request for Proposal' in response to the project brief.

The EOI evaluation process was well documented, and the short listing decision was justified on the basis of the requirements and the selection criteria declared in the EOI evaluation plan.

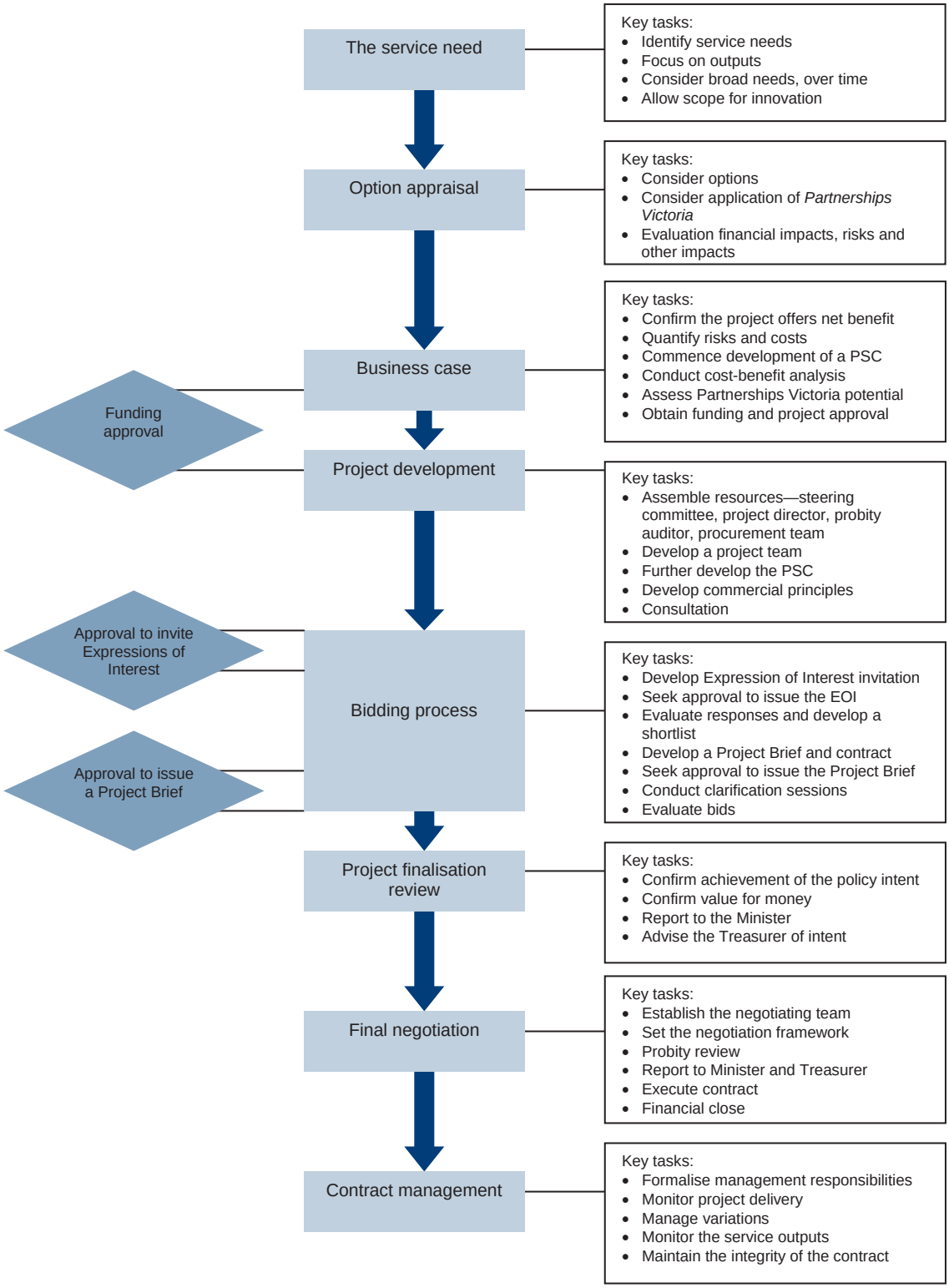
Project brief evaluation

A project brief evaluation plan was developed documenting the methodology to be used in the evaluation of proposals. It outlined the formation of an evaluation panel and delegated the responsibility of carrying out the evaluation to the steering committee. The evaluation panel assessed the submissions with advice from three sub-panels—technical, commercial and service. The sub-panels had access to expert advisers to assist in the evaluation process.

The evaluation panel received three proposals at the project brief stage. Each proposal was rated, ranked or scored by the sub-panels on the basis set out in the evaluation plans. Each sub-panel prepared a detailed report to the evaluation panel summarising the proposals and explaining the scores that were awarded.

The evaluation process at both the EOI and project brief stage was well documented. The decision was justifiable on the basis of the requirements and the selection criteria declared in the project brief. The process was fair to all respondents.

Figure 4A
Procurement process diagram



Source: Partnerships Victoria Contract Management Guide, page 81, figure 5.1.

The façade and main entry of the new hospital receiving final finishing works.

Extended bidding process—revised evaluation

Following the assessment of the response to the project brief, the evaluation panel invited each of the respondents to participate in an extended bidding process. The decision to recommend that all three respondents participate was due to the panel's view that none of the respondents could be ranked either first or last.

Various design, commercial and service-related issues required improvement in this unplanned phase of the procurement process. The project brief evaluation plan was not updated as a result of the extended bidding process.

4.2.2 Development of a comprehensive project brief

The project brief is a comprehensive document, with the project objectives in the project brief consistent with the business case. Although there were some minor revisions subsequent to release, this is reasonable, as changes are expected at the design and construction phase: for example, changes to room sizes.

The project brief was prepared by DHS and approved by government in April 2004.

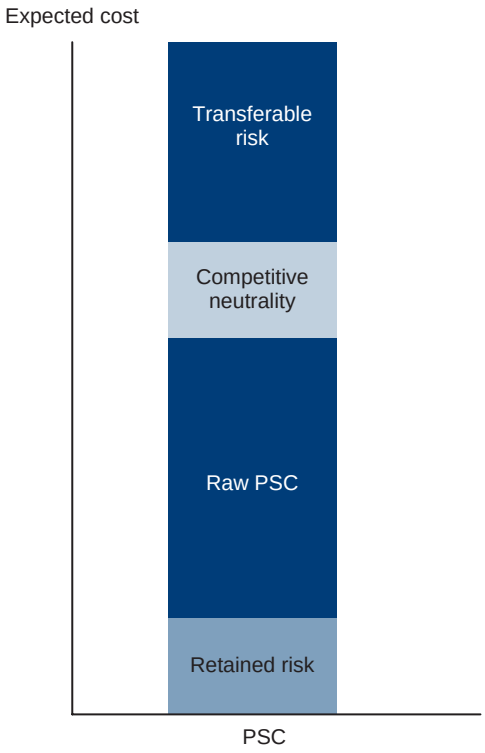
4.2.3 Development of a Public Sector Comparator

The Public Sector Comparator (PSC)

The PSC was one of a range of assessment criteria utilised during a *Partnerships Victoria* procurement process. The PSC estimates the hypothetical risk-adjusted cost if a project were to be financed, owned and implemented by government. The PSC is also based on the most efficient form and means of government delivery.

Figure 4B sets out the four components that make up the PSC cost.

Figure 4B
Components of the PSC



Source: Partnerships Victoria PSC Technical Note June 2001, page 6, section 2.4.

Figure 4C defines each element of the PSC.

Figure 4C
Definition of PSC Components

Retained risk
Retained risk is any risk not to be transferred to a bidder. The cost of retained risk is included to provide a comprehensive measure of the full cost to government in a PSC. Examples of retained risk are planning permission or cultural artefacts.
Raw PSC
The raw PSC provides a base costing under the public procurement method. This includes all capital and operating costs, both direct and indirect, associated with building, owning, maintaining and delivering the service (or underlying asset) over the same period as the term under the *Partnerships Victoria* proposal and to a defined performance standard as required under the output specification.
Competitive neutrality
Competitive neutrality adjustments remove any net competitive advantages that accrue to a government business by virtue of its public ownership. This allows a fair and equitable assessment between a PSC and bidders.
Transferable risk
Transferable risk is any risk transferable to a bidder. Examples of transferable risk are construction costs, construction delays and materials cost escalation.

Source: Partnership Victoria PSC Technical Note June 2001, page 7.

4.2.4 Use of a Public Sector Comparator

To use the PSC appropriately in the evaluation process, adjustments are made to both the total PSC, and the bid valuations where necessary. This enables 'like-for-like' comparisons of all bids.

Once adjustments are made, the PSC is compared to the net present cost (NPC) of the bids received. The NPC of the private sector bids is compared to the PSC in order to assist in determining whether the project, if conducted under a *Partnerships Victoria* structure, would deliver value for money—that is, if the NPC of the bids is less than the PSC.

A preliminary PSC was developed in March 2003 (investment evaluation report) and again in September 2003 (business case) before the commencement of the procurement process. The final PSC was completed in April 2005 at contract close.

Figure 4D below provides a breakdown of the PSC at key stages of the RWH planning and procurement process stages.

Figure 4D
Breakdown of PSC at key planning and procurement stages

Date	Stage	Raw PSC $M	Transferred risk $M	Competitive neutrality $M	PSC [(a)] $M
Sep-03	Business case	234.69	21.77	27.11	283.57
Mar-04	Project brief	291.13	20.62	17.13	328.88
Oct-04	Bid evaluation	312.75	26.21	17.75	356.71
Jun-05	Financial close	313.01	26.10	17.75	356.86

(a) The state's estimates of retained risk have been excluded from these figures due to commercial sensitivity.

Source: Victorian Auditor-General's Office analysis of DHS information.

Changes to the PSC were discussed, documented and endorsed at the steering committee and the Treasurer's approval was given for the adjustments.

PSC use at bidding stages

The PSC was used at each of the project brief and bid evaluation stages.

Appropriate adjustments were made at each stage of the evaluation process from receipt of the bids in October 2004 to financial close in June 2005. Adjustments made to the PSC to enable a like-for-like comparison with bids were:

- retained risk adjustments (as the state holds this risk under either scenario)
- land tax adjustment (not considered by the bidders but included in the PSC)
- car park revenues (The State Government decided after the PSC was calculated to retain the car park revenues. To make the PSC comparable to the bids, the value attributed to the car park revenues under the PSC was added back.).

Final Public Sector Comparator

The 'final adjusted PSC' is the PSC used to make the final evaluation of the bids received, which also excluded the state's estimate of its retained risk.

The final adjusted PSC was $367.7 million with the NPC of the adjusted bid at financial close at $365.24 million. The adjusted bid at financial close was under the adjusted PSC, representing a cost saving for the state of $2.46 million or 0.67 per cent.

Figure 4E
Summary of PSC and bid at financial close

	$M
Final adjusted PSC	367.70
NPC of adjusted bid at financial close	365.24
Difference	2.46
Saving	0.67%

Source: Victorian Auditor-General's Office analysis of DHS information.

Both the Minister for Health and the Treasurer were advised of the final adjusted PSC and the NPC of the adjusted bid at financial close.

The new hospital under construction.

4.2.5 Other value for money considerations

Apart from the PSC, the following other value-for-money factors identified in the *Partnerships Victoria* guidelines were examined during the bid evaluation:

- **Risk transfer**—risk allocation was carefully considered during the development of the PSC. (A detailed breakdown of risk allocations for this PPP is contained at Appendix A.)
- **Whole-of-life costing**—full integration of up-front design and construction costs with ongoing service delivery, operational, maintenance and refurbishment costs was incorporated into the PSC.
- **Innovation**—the project company's proposal incorporated a high quality engineering solution for the hospital that will facilitate future operational changes and includes an innovative ecologically sustainable development solution involving 100 per cent fresh air ventilation in patient rooms. This design provides an innovative approach which will have both energy and infection control benefits for the facility.
- **Asset utilisation**—the gross floor area and gross departmental area of the project company design is significantly greater than that of the reference project that informed the PSC. [2]

4.2.6 Quality review of consultant work

The RWH project team worked closely with consultants and relied on their expertise during development of the investment evaluation and business case, as well as the project brief, bid evaluation and project agreement phases of the project.

The project team advised that there were quality reviews of the consultant's paperwork and output that were completed as part of their internal monitoring process, however, no documented evidence of such reviews could be provided.

In summary, the quality review process was not documented, and is not an internal DHS requirement.

[2] *Partnerships Victoria* Guidance Material Practitioners Guide, page 6.

4.3 Conformance to procurement rules and guidelines

This audit assessed whether the procurement for the redevelopment project was conducted in line with relevant policy and guidance, and focussing on whether:

- the procurement approach complied with *Partnership Victoria* Guidelines
- any post-tender project scope changes or proposed contractual terms materially impacted on the tender put to market (i.e., all tenderers were given fair/equal opportunity to tender)
- the project agreement allocates risk between the parties in line with the *Partnerships Victoria* guidelines and protects the state's interests (including professional indemnity, dispute resolution, and abatement/liquidated damages clauses)
- probity was enforced and maintained through all key procurement stages, including any structured negotiations and prior to awarding the contract
- the state was provided with soundly based assurance that the conduct of the procurement process met probity and other relevant government procurement requirements.

Staff station and reception for the Neonatal Intensive Care Unit.

4.3.1 Compliance with *Partnership Victoria* guidelines

The *Partnerships Victoria* Practitioners Guide provides a framework for the establishment of partnerships with private sector entities for the provision of public infrastructure and related services.

Documentation relating to all of the required procurement milestones was available and requirements were conducted in line with *Partnerships Victoria* guidelines.

In particular, the following was observed:

- a PSC was constructed and updated throughout the evaluation process
- an output specification was produced (in the form of the project brief)
- appropriate approvals were obtained
- the evaluation of the bids was undertaken against previously determined criteria stipulated in the evaluation plan.

The state conducted a competitive tender process to identify the preferred private sector consortium to deliver the RWH redevelopment.

The procurement approach complied with the expected elements of VGPB policy and guidance and the procurement exercise complied with the *Partnerships Victoria* guidelines.

4.3.2 Fairness and equity of tender process

Changes to the project after the signing of the project agreement were reviewed to determine if any post-tender project scope changes or proposed contractual terms materially impacted on the tender put to market.

Variations to the contract did not result in a material change from the project brief and did not materially impact on the tender put to market.

The Project Agreement permits the parties to amend or vary the Project Agreement provided that such amendment or variation is made in writing executed by both parties.

The parties agreed to vary the Project Agreement in the manner set out in two deeds of variation. The first deed of variation was the result of updated DHS design guidelines that required specification changes to be made to the design of the new building.

The second deed of variation introduced amending instruments. This is the formal document that details the agreed changes to the service specifications or design requirements that can be entered into by the Project Director and the project company. The second deed of variation gave rise to four amending instruments, but did not impact on time or project cost.

The Project Agreement also outlines a process for introducing State Initiated Modifications (SIMs). There have been 15 SIMs to April 2008 (one rejected, seven accepted, and seven requested but not yet finalised). The total cost of the SIMs was less than $1 million. Further project funding was not required for the modifications as these were either funded by external stakeholders or from within the approved project budget.

A summary analysis of the post-tender changes is provided below:

Figure 4F
Summary analysis of the post-tender changes

Documents	Scope change	Material
Deeds of Variation	Yes—contract change could affect scope.	No—although 2nd Deed of Variation facilitates scope changes (as it gives rise to future amending instruments).
Amending Instruments	Yes.	No—minor changes that are expected as part of a construction process. No time or cost impact.
State Initiated Modifications	Yes.	No—modifications have not resulted in material scope change.

Source: Victorian Auditor-General's Office analysis of DHS information.

The completed Neonatal Intensive Care Unit.

4.3.3 Risk allocation between the parties

One of the principles of the *Partnerships Victoria* is the allocation of key project risks to the party who can best manage those risks in order to achieve value for money and the best outcomes for the state.

Further guidance including government preferred risk allocations in PPP projects is provided in the *Partnerships Victoria* Risk Allocation and Contractual Issues Guide.

Risk allocation in the Project Agreement

The risk allocation in the Project Agreement is consistent with *Partnerships Victoria* guidelines. In *Partnerships Victoria* projects, the state seeks to achieve best value for money by allocating particular risks to the party best able to manage them at the least cost. This process resulted in risks being either:

- retained by the state
- transferred to the private sector
- shared between the parties.

The Project Agreement established the obligations of each party in relation to these risks. (A detailed breakdown of the various risks and their allocation is provided at Appendix A of this report.)

Professional indemnity, dispute resolution and liquidated damages clauses

The Project Agreement requires the project company to indemnify and keep the state and the state's associates indemnified from and against all claims, and the Project Agreement stipulates the method for dealing with disputes.

In terms of construction, if final completion does not occur by the required completion date the project company must pay the state by way of liquidated damages the amounts determined in accordance with the a formula in the Project Agreement.

During the operating phase, in the absence of negligence on the part of the project company, abatement of the service payment is the sole remedy available to the state for a failure to meet the service standards.

The payment and abatement regime reflected in the Project Agreement supports the risk transfer objectives of the state and provides appropriate financial incentives for the project company to deliver the project on time and meet its obligations during the operating phase.

4.3.4 Probity through key procurement stages

To ensure that public sector agencies conduct their commercial transactions with probity, the VGPB has produced the Probity Best Practice Advice and Probity Policy. The procurement process was assessed against the probity requirements set out in these VGPB guidelines.

In order to assess whether appropriate records were maintained, the following items have been examined:

- probity reports
- steering committee minutes.

The probity auditor was present at all steering committee meetings where the evaluations were discussed. Probity issues were discussed and responses reported at the steering committee meetings.

The probity plan met 10 of the 12 VGPB requirements. The two requirements not met were:

- the use of a data room (optional)
- a description of the requirement to develop a database for recording keeping (as recommended in the VGPB Probity Plan template).

We assess that overall expected standards of probity were maintained and enforced for this procurement.

5 Delivering high quality infrastructure and services

At a glance

Background

The Government of Victoria's *Partnerships Victoria* approach focuses on the purchasing of service outputs with agreed quality, quantity and timeframe parameters. This approach differs from traditional public sector procurement methods which usually focus on delivery of an asset or a specified service input.

As the focus of public private partnerships (PPPs) is on the long term, performance monitoring during both the construction and the operating phase is critical to make sure that expected value is being achieved.

Key findings

- The state has been adequately managing the design and construction phase of the project. The relevant frameworks and structures in place provide assurance that the design and construction phase was managed effectively.
- The actual project costs are expected to be within the approved budget.
- Construction milestones have been met to date, including the final completion date of 12 June 2008. Plans in place for the relocation are comprehensive and include all relevant parties to the move.
- Information in the Project Agreement and schedule regarding expected service delivery specifications is reasonable in terms of the required services to be delivered.
- *Partnerships Victoria* guidelines were not fully complied with regarding the suggested timing of development and finalisation of the Contract Management Plan and Contract Administration Manual.
- At the date of this report, the Contract Administration Manual remains incomplete with some components due for completion and endorsement prior to the commencement of the operating phase, and other critical components are not due for completion until November 2008, after the commencement of the operating phase.

At a glance – *continued*

Key recommendations

It is recommended that DHS:

- fully document the processes designed to manage, monitor and review the performance monitoring program and the abatement process prior to the commencement of the operating phase **(Recommendation 5.1)**
- expedite its consideration and approval of the formal establishment of a contract management unit. This unit should be adequately resourced to ensure an effective contract management function is performed during the operating phase **(Recommendation 5.2)**
- complete and endorse the Contract Administration Manual as a matter of urgency to supplement the Policy and Procedures Manual prepared by the project company. **(Recommendation 5.3)**

It is recommended that DTF:

- review the Partnerships Victoria contract management guidance in relation to Contract Management Plans and Contract Administration Manuals to ensure it is clear and unambiguous, particularly in the following areas:
  - whether a Contract Management Plan and Contract Administration Manual needs to be prepared at the design and construct and/or operating phases of the project
  - whether Contract Management Plans need to be re-submitted to government if materially amended after initial noting. **(Recommendation 5.4)**

5.1 Introduction

The Government of Victoria's *Partnerships Victoria* approach focuses on the purchasing of service outputs with agreed quality, quantity and timeframe parameters. This approach differs from traditional public sector infrastructure procurement methods which usually focus on delivery of an asset or a specified service input.

Partnerships Victoria differs to traditional 'construct only' contracts by offering long-term service contracts with ongoing performance based payments, instead of upfront milestone payments.

As the focus of public private partnerships (PPPs) is on the long term, performance monitoring during both the construction and the operating phase is critical to make sure that expected value is being achieved.

To assess whether there is adequate supervision to ensure delivery of high quality infrastructure and services for the RWH redevelopment project, the audit evaluated:

- the state's involvement in the design and construction phase of the project
- arrangements to supervise the long term role of the private sector partner.

5.2 Design and construction phase

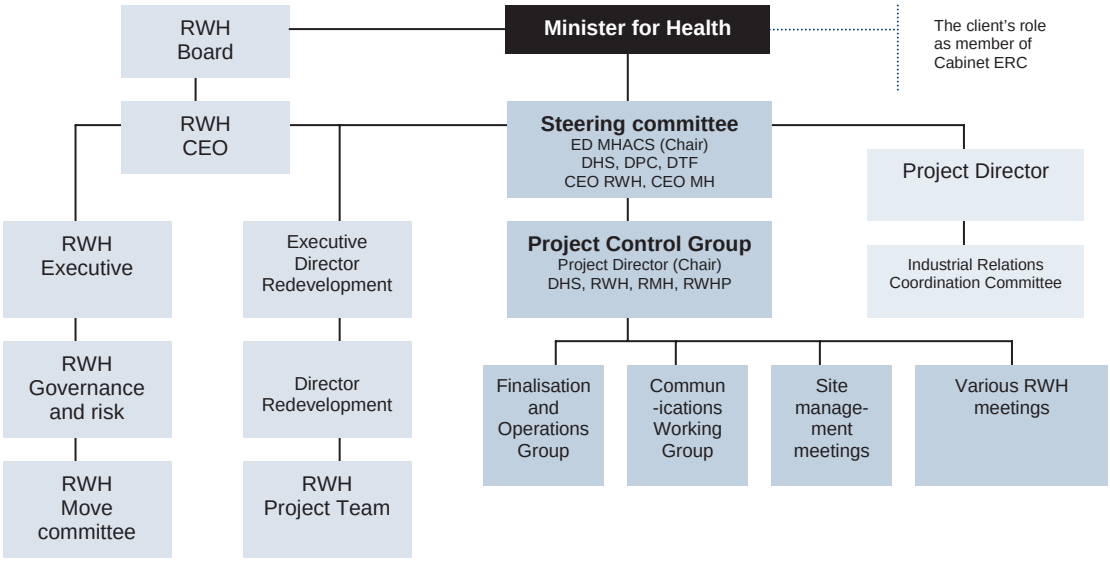
5.2.1 Project governance and management systems

Project governance

The RWH project steering committee is the peak project governance body and supervises delivery of the project. The steering committee is accountable to the Minister for Health and the Secretary of the Department of Human Services (DHS). DHS's Executive Director of Metropolitan Health and Aged Care Services is the appointed chair of the steering committee.

Figure 5A provides a diagram of the governance arrangements in place for the project during the design and construction phase.

Figure 5A
RWH redevelopment project governance structure



Source: DHS Major Projects.

The Project Control Group (PCG) provides a focus point for the state and the private sector project company to meet and review the overall progress of the project. The PCG, chaired by DHS, has delegated responsibility from the Minister for Health and DHS Secretary for the planning, design, construction and commissioning of the new hospital.

Various parties are represented at the PCG including DHS Major Projects, RWH, Melbourne Health, Royal Women's Health Partnership Pty Ltd (the project company), Baulderstone Hornibrook Pty Ltd (the builder) and United Group Limited (the services and maintenance operator). The project's independent reviewer also attends.

Meetings of the PCG are designed to:

- provide high level direction for the project
- review monthly reports on all high level issues associated with the project
- monitor procurement, contracting and commissioning implementation
- review quality aspects of the project.

The PCG includes all the relevant stakeholders required to achieve its terms of reference and has been an effective forum for discussions between the state and the project company in order to deal with any emerging issues during the construction phase.

Overall, the governance framework for the project provides for effective communication between relevant parties as well as the assessment, monitoring, actioning and reporting of emerging issues and risks.

Project management systems and processes

The following project management systems and processes[1] for the design and construction phase of the project were assessed:

- **integration**—effective and accountable governance/supervision systems in place
- **scope**—well defined and specified in detail, with variations actively managed
- **time**—realistic and achievable milestones and deadlines in place
- **cost**—budget versus actual costs are analysed and variations minimised wherever possible
- **quality**—active quality assurance of materials, design and construction
- **human resources**—capable and skilled personnel employed in key areas
- **communications**—effective strategy for all identified stakeholders
- **risk**—comprehensively identified, documented and actively managed.

Integration

Project relationships, roles and responsibilities of the groups and committees involved in the design and construction phase have been well defined and articulated across the project documents.

The project is operating in an integrated manner with all the various stakeholders, both internal and external to the project, regularly consulted on the project. The DHS project team has been managing the construction phase of the project under a set of processes that have been agreed by the project steering committee.

Scope

The overall scope of the construction of the hospital has not changed materially since the approved business case, with the high-level objectives of the project captured in the Project Agreement.

The Project Agreement permits the parties to amend or vary it, provided that amendments or variations are in writing and executed by both parties. The Project Agreement has been varied twice. These variations have resulted in minor changes with no impact on project time or cost.

The Project Agreement also allows the state to request a modification to the project company at any time, known as State Initiated Modifications (SIMs). To date, there have been 15 SIMs for the project. These SIMs have been for minor scope changes or amendments which are not unexpected for a project of this size and complexity. These SIMs have not had a material impact on the cost and scope of the project.

[1] These processes have been defined within the Project Management Body of Knowledge (PMBOK) developed by the Project Management Institute <www.pmi.org>. We have used eight of the nine PMBOK knowledge areas, except for project procurement, which is separately analysed and reported in Part 4 of this report.

Time

There are no specific key performance criteria and standards set out in the Project Agreement for the construction phase, however, the agreement states that the project company must achieve the following construction milestones:

- completion date of demolition works by 10 September 2005 (achieved)
- completion date for the loading dock by 18 January 2008 (bettered by several months and handed over on 31 October 2007)
- final completion by 12 June 2008 (achieved).

The PCG monitors the project schedule by receiving a report from the builder and the project company at their monthly meetings.

The approved business case originally anticipated that completion of construction—including full commissioning of the new RWH—would be achieved by December 2007. However, due to the extra time required for the procurement process, the project completion date was moved by six months to June 2008.

The project was on time for design and construction, with the hospital fully commissioned on 22 June 2008.

This provides a degree of validation of the original time estimates, and indicates that the project company in conjunction with DHS is effectively managing and integrating subcontractors and other stakeholders involved in the project.

Cost

The costs of the project construction are being fully met by the project company during the construction phase of the project. As the project is a PPP, funding for the delivery of the facility is an agreed sum, disbursed over the life of the agreement in accordance with the payment schedule contained in the Project Agreement.

The state will commence payment of Quarterly Service Payments (QSP) when the building is commissioned. The QSP cover the build cost and the cost of delivering services. The QSP will be managed through a performance monitoring and abatement program.

Other costs associated with the project, such as enabling works and project management costs, including project contingency, are appropriately monitored and reported to government. The project is being delivered within the approved funding envelope.

Figure 5B sets out the total budget approved by government for the RWH redevelopment project costs, and actual costs as at 28 February 2008, as provided by DHS.

Figure 5B
Approved budget and actual/projected costs for the RWH project

Funding	Total approved budget $M	Actual budget at 29 May 2008 $M
Enabling works	39.75	42.35
Relocation and contingency [(a)]	13.60	4.05
Project management	14.67	14.48
Total project cost	**68.02**	**60.88**

(a) Total budget includes a subsequent approval by the Minister for Health to increase the budget relating to enabling works from $39.75 million to $42.35 million, which was effected by augmenting contingency funds by $2.6 million. This increase relates to the upgrading and relocation of the existing Royal Melbourne Hospital kitchen.

Source: Victorian Auditor-General's Office, based on DHS data.

DHS has advised that projected actual costs are on target.

Quality

The project brief specified detailed project outputs, including quality expectations. The brief was part of the Request for Proposal which detailed specifications and user requirements which were incorporated into the Project Agreement.

The project company is contractually obliged to satisfy the performance and functionality requirements, and provide a facility that is 'fit-for-purpose' at final completion.

Under the Project Agreement, an Independent Reviewer has been contracted to ensure that scope requirements, as outlined in the Project Agreement, are met. The independent reviewer is required to provide an endorsement on final completion, to ensure that the final design satisfies the project's objectives.

The project director also receives a separately commissioned report on construction status which is not tabled at the PCG meeting. This report was instigated by DHS to provide independent confirmation of the information provided by the builder and the project company, as assessed by the independent reviewer.

A view from the West of the newly built hospital.

Human resources

Descriptions of the various key roles and responsibilities for organisations and individuals involved with the project are provided in the Project Agreement.

Position descriptions have been produced by the various state entities that have staff allocated to the project, detailing accountabilities, knowledge and skills, expertise, desirable qualifications, and selection criteria for these roles.

The personnel assigned to the design and construction phase of the project are being managed in a controlled manner. There is also evidence that the personnel assigned to the project have the skills necessary to undertake the various project roles.

Communications management

To ensure effective management of its communications, DHS developed a communication strategy designed to maximise understanding of and support for the RWH redevelopment project. This formed part of the Communications Plan (2003–2008). To achieve the required communication outcomes, the plan provides:

- an analysis of the communication environment in which the project will be conducted
- a detailed action plan based on communicating the 'substance' of the project and providing ongoing consultation with both the public and numerous key stakeholder groups
- communication protocols addressing the roles of the RWH project team, DHS, the minister's office and all project consultants, contractors and providers.

There has been a coordinated approach to communications with both key stakeholders and the public during the design and construction phase.

Risk

Risk management is an integral part of the management of the project. DHS, in conjunction with RWH and Melbourne Health and various consultants and advisers, developed a comprehensive risk management matrix for the design, construction and commissioning phase of the RWH redevelopment project.

This document has been structured in accordance with Australian Standards (AS/NZS 4360:2004) and the state's *Partnerships Victoria* Contract Management Guide.

The project's construction risks and issues have been identified, and prioritised according to impact and likelihood. The risks and issues are monitored, managed and reported on a regular basis.

A summarised risk register is presented to the steering committee as a standing agenda item. The risk register is updated with input from the PCG and the steering committee, with the project director responsible for the updating of the risk register. The project director attends both the steering committee and PCG meetings.

Although construction risks have largely been transferred to the project company, and it is responsible for the management of these risks, the PCG is responsible for monitoring and reporting of construction risks. Further comfort over the status of these risks is also obtained from the independent reviewer and the independent report supplied solely to the project director.

Emerging risks and issues are effectively identified, monitored and managed proactively with key stakeholders. A number of risks arose during the construction phase, however, they have been well managed and have not had an impact on the project in terms of time or budget.

5.2.2 Incentives and sanctions/penalties

The main incentive for the project company to achieve construction milestones is that it will not begin receiving service payments (QSP) until final completion has been achieved and certified by the independent reviewer.

The Project Agreement includes an abatement program that will reduce the QSP as a result of performance issues with the service provider, including building maintenance. This encourages the project company to ensure the facility is 'fit-for-purpose' as any building maintenance issue could result in reduced QSP.

A partly fitted out operating theatre in the new hospital.

5.2.3 Interfaces between the existing Royal Melbourne Hospital site and the redevelopment project site

Interface issues with the Royal Melbourne Hospital during the construction phase have been dealt with effectively through the Project Management Plan (PMP).

The PMP defines the objectives, organisation, responsibilities, authorities, procedures, controls and processes that are to apply to the project in relation to:

- environmental management
- construction management.

This integrated PMP comprises of a series of component plans, which incorporate project specific objectives, management strategies, implementation measures and procedures in relation to:

- environmental management
- pre-construction management
- construction management
- procurement management
- traffic management
- OH&S management
- industrial relations management
- community relations
- completion
- induction.

Other methods used to manage the interface include:

- site management protocols—which include communication, traffic management, environment protection protocol, site boundaries, etc.
- site meetings with stakeholders.

Adequate processes/procedures are in place to effectively manage any interface issues during the construction phase between all the key stakeholders.

5.2.4 Transitioning patients, staff and equipment to the new hospital

The Project Agreement sets out requirements for a transition process, including the need for a transition plan and a training plan.

Transition plan

The transition plan was prepared in consultation with DHS, RWH and the Frances Perry House operator. This document provides an outline of the project company's obligations under the Project Agreement to enable the new hospital to operate and was endorsed on 22 February 2008.

The project company and the state must comply with the endorsed transition plan. The document is comprehensive and complies with the requirements of the Project Agreement.

Training plan

The training plan was prepared by the project company following detailed consultation with RWH, Frances Perry House and the state, to set out the scope and methodology of training and orientation to be provided by the project company, both prior to commencement of the new hospital functions and during the operating phase.

The plan was endorsed by the project director on 7 January 2008. The project company must comply with the endorsed training program and the state must ensure that it and its associates comply with the endorsed training program.

Royal Women's Hospital move plan

In addition to the requirements of the Project Agreement, the RWH has developed a 'move' plan to facilitate the relocation and associated organisational change, in so far as it affects the RWH.

This document relates to how RWH is planning to move patients, staff and equipment from the current hospital site to the new hospital and the delivery of hospital services, and is distinct from the transition plan, which relates to the delivery of obligations under the Project Agreement. The transition plan is also a comprehensive document.

Completion requirements as per the Project Agreement

Further to these requirements relating to the transition plan and training plan, the Project Agreement requires the project company to submit, prior to the 12 June 2008 (final completion date), the following four requirements:

- policies and procedures manual
- hand-over package
- performance monitoring program
- asset management plan.

DHS advised that all of the above requirements are expected to be completed prior to the final completion date.

5.2.5 Conclusion on the construction phase

Overall, the design and construction phase of the project is being well managed. The relevant frameworks and structures in place provide assurance that the design and construction phase was managed effectively.

In particular, the governance of the project provided an effective framework for communication with the relevant parties as well as the assessment, monitoring and actioning of emerging issues and risks.

Project management systems and processes are sound and effective. Independent assurance was provided regarding the progress of construction with appropriate sanctions and penalties in place for non compliance with the Project Agreement.

Construction milestones have been met to date, with the final completion date on target for 12 June 2008. The plans in place for the relocation in June are comprehensive and include all relevant parties.

The state’s actual project costs are expected to be within the approved budget costs.

The new hospital's internal atrium.

5.3 Operating phase

To assess the adequacy of arrangements to supervise the long term role of the private sector partner the audit evaluated whether:

- key performance criteria and standards can be measured for compliance
- performance monitoring and reporting arrangements are appropriate
- contract management and contract administration plans are in place and supported by suitable governance arrangements and expertise.

5.3.1 Key performance criteria and standards

The Project Agreement specifies a number of services to be provided by the private sector during the operating phase, including:

- general services (management and corporate activities)
- helpdesk (for building faults and service issues)
- accommodation (integrity and functionality of the building fabric, building services, public health and utility systems, furniture, fixtures and equipment within the facility)
- utilities and medical gases management
- cleaning and hotel services (hotel services comprise of patient and general transport duties, food service, bed making, waste and dirty linen removal, sanitary disposal, and general support duties)
- security
- car parking
- grounds and garden maintenance
- pest control.

Each has a ‘minimum service specification’ set out in Schedule 1 to the Project Agreement. Every output described in the service specification has a corresponding ‘performance parameter’.

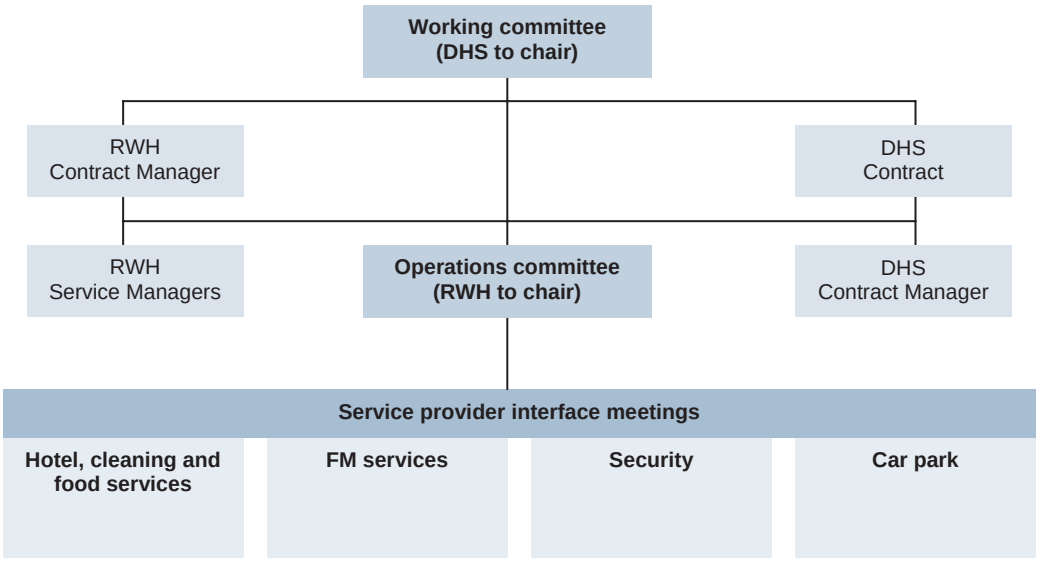
A performance parameter describes the level of performance (i.e., agreed pass or fail benchmark) that the project company should achieve to comply with the output specification.

Performance against documented benchmarks will be used in the second and subsequent years of operation to set annual key performance indicators which are directed at driving service improvement. The project company must agree the ranges for each service with the hospital operator and the state’s contract administrator.

5.3.2 Performance monitoring and reporting

During the operating phase, a working committee and supporting performance management interface structures will be set up (as required by the Project Agreement) to discuss matters relating to the provision of services by the private sector party. Figure 5C shows the governance structure for the operating phase of the PPP contract.

Figure 5C
Governance structure for the operating phase



Source: Department of Human Services.

The project company is required to develop a performance monitoring program and report against this program as a means of monitoring its own performance in providing the services. Reporting will be daily, weekly or monthly, depending on the performance parameter.

DHS and RWH will have direct access to the operator's IT system, ePremisys, where the data for the more than 200 parameters will be recorded. This will allow DHS and RWH to monitor performance daily, as well as conduct audits and spot-checking as required.

The project company must also prepare a monthly performance report (on every indicator, as well as any other outstanding issue) to be delivered to the Contract Administrator. The monthly performance report must provide sufficient information to enable the Contract Administrator to calculate the QSP. The monthly performance report must also specify any failures and the project company's estimate of the deduction to be made from the QSP.

The project company is required to review its performance monitoring plan half-yearly during the operating phase or as otherwise agreed, and report the results to the Contract Administrator.

5.3.3 Contract management and administration plans

Specific guidance on contract management is provided in the *Partnerships Victoria* Contract Management Guide.[2] The guidance requires a 'contract management strategy' and a 'contract management team' to be established at the beginning of the procurement stage, with transfer of their responsibility to the contract director/administrator at the completion of the procurement process.

The Project Agreement specifies that a contract administrator for the RWH project must be appointed at least three months prior to the proposed completion date (12 June 2008). Prior to this date the state is represented by the project director.

A contract administrator has been appointed for the operating phase. The role of the contract administrator is to exercise the powers, duties and discretions detailed in the Project Agreement on behalf of the state, and monitor the project company's compliance with the obligations detailed in the Project Agreement.

Formal approval is currently being sought for the establishment of a contract monitoring and management unit within DHS and adoption of a contract management strategy to manage the RWH Project Agreement during the operating phase.

[2] *Partnerships Victoria* Contract Management Guide, Chapter 4, Figure 4.2.

Contract Management Plan (CMP)

The RWH's CMP is the first step in developing and maintaining an effective contract management strategy. It provides the foundation for the development of the Contract Administration Manual (CAM) and aims to establish a culture of continuous improvement through the development and systematic review of the contract management tools and processes throughout the life of the contract.

Specifically the CMP covers all material areas of contract administration under the Project Agreement and is the precursor to the CAM.

The *Partnerships Victoria* Contract Management Guide provides specific guidance about the requirement for a CMP that itself requires:

- an initial CMP to be developed early (and with sign-off obtained from senior management) in the procurement process prior to the commencement of the CAM
- a final CMP (even before the completion of the CAM) to be completed as soon as possible after the execution of the contract during the transition from procurement to contract management
- final CMP and details of the CAM to be submitted to government within three months of contract execution to inform government of the proposed contract management strategies.

The *Partnerships Victoria* guidance states that the implementation of a CMP—by the development of an effective CAM—is a key activity for the state during the procurement phase of the project and the transition from the procurement phase to construction and service delivery.

Audit reviewed the approved CMP for the RWH and observed the following:

- the CMP was submitted to and noted by government in April 2006. This was 12 months after contract execution (April 2005), which did not conform with *Partnerships Victoria* guidance
- the CMP, specifically the CAM outline, was updated in April 2008. The changes relate to the target dates for the completion of various CAM components relating to the operating phase.

Contract Administration Manual (CAM)

The CAM is a centralised collection of documentation for all of the tools and processes used in managing the contract.

Specific guidance on the CAM is provided in the *Partnerships Victoria* Contract Management Guide which states that:

- the CAM is developed hand-in-hand with the development of the contract
- a CAM is developed to assist the contract management function during the design and construction phase of the project.

A CAM was not developed during the construction phase, departing from *Partnerships Victoria* guidelines. Documented procedures to manage the construction phase of the Project Agreement were separately developed; however, these were not consolidated in the form of a CAM, as required by the guidelines.

A review of the CAM outline (as contained in the CMP) indicates that all components, as defined in the *Partnerships Victoria* Contract Management Guide, will be included.

The CMP was updated in April 2008 with the target dates for completion of some CAM components changed from March 2006 through to November 2006, to May 2008 and November 2008.

The relevant CAM components not due for completion until November 2008 (i.e., five months after the commencement of the operating phase) are listed below:

- issues management
- contract communications
- public and media communications
- contract change management
- contract management quality assurance
- risk management
- governance, probity and compliance policy
- contingency planning
- knowledge and information management
- records and document management.

These CAM components are critical to the effective management of the contract; and their completion after the commencement of the operating phase increases risks for the management of the contract.

As the CAM had not been completed at the time of this audit, it is not possible to conclude on the adequacy of the proposed arrangements for contract administration.

However, there is evidence that DHS has made significant efforts to finalise these arrangements prior to commencement of the operating phase.

Policy and procedures manual

A policy and procedures manual has been prepared as required by the Project Agreement. This has been issued by the project company and has been endorsed by the state, with some technical appendixes still under discussion.

The contents of this document have been developed by the project company and consortium members in close consultation with DHS, RWH and Frances Perry House.

This consultation has been facilitated by the establishment of the Finalisation and Operations Group (FOG). This group consisted of representatives of the various nominated stakeholders.

The CAM, when completed, will supplement the Policy and Procedures Manual.

Operating Deed between state parties

The Operating Deed is an interface agreement between DHS, RWH and Melbourne Health to facilitate required service delivery. At the time of this audit, the deed had been agreed 'in principle' for execution.

The purpose of this deed is to identify issues which may arise in the operating phase which will affect, or be affected by, the requirement for a close working relationship between DHS, Melbourne Health and RWH.

This deed records the principles under which DHS, RWH and Melbourne Health will cooperate to ensure that the state's obligations under the Project Agreement are fulfilled.

View of Melbourne's skyline from the new hospital.

5.3.4 Conclusion on operating phase

The information contained in the Project Agreement and schedule about expected service delivery specifications is reasonable in terms of the required services to be delivered.

Partnerships Victoria guidelines were not fully complied with regarding the suggested timing of development and finalisation of the CMP and CAM.

At the time of the audit the CAM remains incomplete with some components due for completion and endorsement prior to the commencement of the operating phase, and other critical components not due for completion until November 2008, which is after the commencement of the operating phase.

Recommendations

It is recommended that DHS:

5.1 fully document the processes designed to manage, monitor and review the performance monitoring program and the abatement process prior to the commencement of the operating phase

5.2 expedite its consideration and approval of the formal establishment of a contract management unit. This unit should be adequately resourced to ensure an effective contract management function is performed during the operating phase

5.3 complete and endorse the Contract Administration Manual as a matter of urgency to supplement the Policy and Procedures Manual prepared by the project company.

It is recommended that DTF:

5.4 review the *Partnerships Victoria* contract management guidance in relation to Contract Management Plans and Contract Administration Manuals to ensure it is clear and unambiguous, particularly in the following areas:

- whether a Contract Management Plan and Contract Administration Manual needs to be prepared at the design and construct and/or operating phases of the project
- whether Contract Management Plans need to be re-submitted to government if materially amended after initial noting.

Appendix A.
Risk allocations for the New Royal Women's Hospital PPP agreement

One of the principles of the *Partnerships Victoria* is the allocation of key project risks to the party that can best manage those risks in order to achieve value for money and the best outcomes for the state.

Further guidance including government preferred risk allocations in PPP projects is provided in the *Partnerships Victoria* Risk Allocation and Contractual Issues Guide.

The risk allocation in the Project Agreement is consistent with *Partnerships Victoria* guidelines. In *Partnerships Victoria* projects, the state seeks to achieve best value for money by allocating particular risks to the party best able to manage them at the least cost.

This process resulted in risks being either:

- retained by the state
- transferred to the private sector
- shared between the parties.

Figure A1 provides details on the explanation of types of risk, preferred allocation according to the *Partnerships Victoria* guidelines, and the actual allocations for the new RWH project.

Figure A1
Analysis of Risk Allocations in the New Royal Women's Hospital

Risk—explanation	Partnerships Victoria guidance—preferred allocation	Project agreement	In-line with PV policy	Assigned in project brief	Aligns with project brief
Site conditions	**Private Party**	**RWHP**			
Risk that unanticipated adverse ground conditions are discovered which cause construction costs to increase and/or cause delay in the progress of the works.		Site risks have been effectively transferred to RWHP.	Yes	Project Co.	Yes—Project Co.
Approvals	**Private Party**	**RWHP**			
Risk that necessary approvals cannot be obtained or may be obtained subject to unanticipated conditions that have adverse cost consequences or cause delay in the progress of the works.		Clause 18 of Project Agreement gives RWHP explicit obligation to obtain all approvals.	Yes	Project Co.	Yes—Project Co.
Environmental	**Private Party**	**RWHP**			
Risk that the project site is contaminated requiring significant expense to remediate.	Private party will generally assume the risk although because of time and cost implication risk sharing may be a cost effective option.	RWHP has taken most contamination risk within the site.	Yes	Project Co.	Yes—Project Co.
Native Title	**State**	**State**			
Risks of costs and delays in negotiating indigenous land use agreements where project site may be subject to native title.	Government will usually take risk on government preferred sites as it generally has a better understanding of the procedures and has special powers of acquisition and use of native title land for infrastructure.	The State bears the risks should a native title claim force RWH Partnership to cease the provision of services.	Yes	State	Yes—State
Cultural Heritage	**State**	**State**			
Risk of cultural heritage discoveries that delay the Works and/or increases the construction costs.	Government will generally take risk on government preferred site as it generally has a better understanding of procedures, and is usually in best position to manage this risk otherwise private party takes responsibility.	Clause 64.2 of the Agreement deals with artefacts. At the request of the State and the State's cost and expense, provide all reasonable assistance in connection with dealing with the discovery of an Artefact.	Yes	Shared	Shared
Site access	**Private Party**	**RWHP**			
Risk that some, or the entire Site is not accessible as expected by the Project Co.	Private party, as it makes the decision to bid on a non preferred site.	Site risks have been effectively transferred to RWHP.	Yes	Shared	No—risks effectively transferred to Project Co.

Figure A1
Analysis of Risk Allocations in the New Royal Women's Hospital – *continued*

Risk—explanation	Partnerships Victoria guidance—preferred allocation	Project agreement	In-line with PV policy	Assigned in project brief	Aligns with project brief
Design, construction and commissioning risks					
Design	**Private Party**	**RWHP**			
The risk that the design of the facility is incapable of delivering the services at anticipated cost.	Private party will be responsible except where an express government mandated change has caused the design defect.	Assumes the demolition, design, construction and finance risks (including cost overruns, permit delays, site demolition and construction delays, and design or construction flaws). Meets the costs of any modification not explicitly requested by the state during construction. (**The State**—Meets the costs of any state-initiated changes requested before construction is completed)	Yes	Project Co.	Yes—Project Co.
Construction	**Private Party**	**RWHP**			
The risk that events occur during construction which prevent the facility being delivered on time and on cost.	Only exceptions being risks of additional costs caused by government.	Assumes the demolition, design, construction and finance risks (including cost overruns, permit delays, site demolition and construction delays, and design or construction flaws). Meets the costs of any modification not explicitly requested by the state during construction. Pays liquidated damages if final completion does not occur by the required date.	Yes	Project Co.	Yes—Project Co.
State initiated variations	**State**				
The risk that DHS changes the design, construction, commissioning requirements or output specifications.		**The State** meets the costs of any state initiated changes requested before construction is complete.	Yes	The State	Yes—State
Industrial Relations	**Private Party**	**RWHP** will have a commercial incentive to accelerate the construction program to avoid a delay in the Commissioning.	Yes	Shared	Shared
Risks of strikes, industrial action or civil commotion during the Construction Phase or Operating Phase.	Government's preferred position is for all industrial relations risk to be held by the private party.	**The State** Industrial Action initiated by State health sector employees delays construction.	Yes	Shared	Shared

Risk—explanation	Partnerships Victoria guidance—preferred allocation	Project agreement	In-line with PV policy	Assigned in project brief	Aligns with project brief
Design, construction and commissioning risks – continued					
Commissioning/Completion The risk that either the physical or the operational commissioning tests which are required to be completed for the provision of services to commence, cannot be successfully completed.	**Private Party**	**RWHP** The State will be intimately involved in the Commissioning Procedure and clause 30 outlines a range of issues that need to be satisfied by RWHP. • The PA contains a detailed Completion Guide that identifies detailed tests that need to be satisfied prior to Completion. • Six months prior to completion, RWHP must prepare a completion manual. • RWHP's QSP do not commence until Completion is verified. This is a powerful commercial incentive. In any event, RWHP remains responsible for undetected defects and latent defects.	Yes	Project Co.	Yes—Project Co.
Sponsor and finance risks					
Sponsor risk Risk that Project Co (or its sponsors) is unable to provide the required Services or becomes insolvent, is later found to be an improper person for involvement in the provision of these Services or financial demands on the Project Co or its sponsors exceed its or their financial capacity causing corporate failure.	**State**	**RWHP** RWHP Financiers will appoint a controller in the first instance. Financiers will have an interest in ensuring the ongoing provision of services (thus protecting their investment). The obligations to deliver Project outputs are not diminished. If services are not delivered, or the Project sponsors abandon, the Default Termination Regime would apply.	No—Project Co.	Project Co.	Yes—Project Co.
Interest rate risk prior to Financial Close Risk that interest rates will change from Proposal submission to Financial Close.	**State**	**State** The State retains the risk associated with interest rate movements prior to financial close.	Yes	State	Yes—State
Interest rate risk after Financial Close. Risk that interest rates during the Project Term differ from those expected.	**Private Party**	**RWHP** RWHP faces the risk of interest rate movements once financial close is completed.	Yes	Project Co.	Yes—Project Co.

Risk—explanation	Partnerships Victoria guidance—preferred allocation	Project agreement	In-line with PV policy	Assigned in project brief	Aligns with project brief
Sponsor and finance risks – *continued*					
Financing risk	**Private Party**	**RWHP**			
Risk that when debt and/or equity is required by Project Co, it is not available at that time and in the amounts and on the conditions anticipated.		Financing risk is transferred to RWHP.	Yes	Project Co.	Yes—Project Co.
State and Federal tax changes (excluding GST).	**Private Party**	**RWHP**			
Risk of changes in State or Federal tax legislation.		Clause 47 of the Agreement limits the States obligation in regards to changes of law including state and federal tax changes.	Yes	Project Co.	Project Co.
Operating risks					
Maintenance and refurbishment	**Private Party**	**RWHP**			
The risk that the design and/or construction quality is inadequate resulting in higher than anticipated maintenance and refurbishment costs.		Undertakes all refurbishment works and maintenance in accordance with the agreement and asset management plan.	Yes	Project Co.	Yes—Project Co.
Obsolescence	**Shared**	**RWHP**			
		Ensures facility has a design life of 50 years.	Yes	Shared	Yes—Shared
		Procures, installs, commissions and maintains a variety of equipment.			
		Undertakes all refurbishment works and maintenance in accordance with the agreement and asset management plan.			
		Maintains the facility to achieve a design life of 50 years Maintains plant and equipment to achieve operational objectives.			
Risk of the contracted service and its method of delivery not keeping pace, from a technological perspective, with competition and/or public requirements.	Private party except where contingency is anticipated and government agrees to share risk possibly by funding a reserve.	**State** Significant portion of the capital cost for the project relates to the construction of the facility, which has a design life longer than the 25-year agreement.	Yes	Shared	Yes—Shared
		Bears the risk of technical obsolescence of the plant and equipment after the 25-year period.			
Changes in public hospital patient demand	**State**				
Variations in the demand for services and hence impacting expected revenues and cost estimates.		**The State**	Yes	State	Yes—State

Risk—explanation	Partnerships Victoria guidance—preferred allocation	Project agreement	In-line with PV policy	Assigned in project brief	Aligns with project brief
Network and interface risks					
Interface risk (1)	**Private Party except**	**State**			
Risk that the core clinical and medical support services provided by the State are delivered adversely.	To the extent that government provides redress for appropriate, discriminatory changes.	The State remains responsible for the delivery of core clinical and medical support services and the risks associated with these activities.	Yes	State	Yes—State
Interface risk (2)	**Private Party**	**RWHP**			
Risk that the delivery of Services by Project Co in a way, which is not specified/anticipated in the Project Agreement, which adversely affects the delivery of core services by the State.		Clause 34 of the Agreement stipulates the project company's obligations.	Yes	Project Co.	Yes—Project Co.
Changes in Law or Policy					
Changes in law or policy (1)	**Shared**	**RWHP**			
Discriminatory Changes in Law/Policy which are reasonably foreseeable at the date of execution of the Contractual Documents.	Government: although the parties may share the financial consequences of capital cost increases in an agreed way for example by the private party meeting a percentage of the cost up to a specific limit and government meeting any excess.	Clause 47 of the Agreement, which deals with changes in law excludes foreseeable changes.	Yes	Project Co.	Yes—Project Co.
Changes in law or policy (2)	**Shared**	**Shared**			
Discriminatory changes in Law/Policy which were not reasonably foreseeable at the date of execution of the Contractual Documents.	Government: although the parties may share the financial consequences of capital cost increases in an agreed way for example by the private party meeting a percentage of the cost up to a specific limit and government meeting any excess.	Clause 47 of the Agreement deals with changes in law. Changes in law are required to be notified to the State by RWHP and negotiated to reach agreement.	Yes	Shared	Yes—Shared
Changes in law or policy (3)	**Shared**	**Shared**			
All other Changes in Law which do not fall within the Change in Law/Policy (1) or (2).	Government: although the parties may share the financial consequences of capital cost increases in an agreed way for example by the private party meeting a percentage of the cost up to a specific limit and government meeting any excess.	Clause 47 of the Agreement deals with changes in law. Changes in law are required to be notified to the State by RWHP and negotiated to reach agreement.	Yes	Project Co.	Yes—Project Co.
Asset risks					
Technical obsolescence	Private party during the contract term, Government may be exposed to residual value risk if asset transferred at end of contract term.	**RWHP**			

Risk—explanation	Partnerships Victoria guidance—preferred allocation	Project agreement	In-line with PV policy	Assigned in project brief	Aligns with project brief
Risk that the design life of the Facility infrastructure proves to be shorter than anticipated, accelerating refurbishment costs.		If the facility does not meet the agreed condition at the end of the contract, the developer is liable for any costs to make good.	Yes	Project Co.	Yes—Project Co.
Condition of the facility upon expiry of the Project Agreement.	Private party during the contract term, Government may be exposed to residual value risk if asset transferred at end of contract term	**RWHP**			
The condition of the facility upon expiry of the Project Agreement is lower than that anticipated.	.	If the facility does not meet the agreed condition at the end of the, the developer is liable for any costs to make good.	Yes	Project Co.	Yes—Project Co.
Residual value of the facility		**State**			
Value of the facility upon expiry of the Project Term is either higher or lower than the written down value.	Private party during the contract term, Government may be exposed to residual value risk if asset transferred at end of contract term.	At the end of the term, the state assumes the risks and costs associated with the remaining economic life of the facility (estimated at 25 years) and the remaining life of the plant and equipment	Yes	State	Yes—State
Force Majeure					
Force Majeure	**Shared**	**RWHP** Must keep the state informed when such event has occurred.	**Yes**	**Yes**	**Yes—Shared**
The risk that inability to meet contracted service delivery (pre- or post-completion) is caused by reason of force majeure events.	Private party takes the risk of loss or damage to the asset and loss of revenue, government takes some risk of service discontinuity both as to contracted service and core service subject to insurance availability and will need to arrange alternative service provision the cost of which will be met from redirected service payments and (if insurable) any shortfall made up from insurance proceeds.	**The State** A Force Majeure event occurs during operations. The State is required to make payments to debt despite the non-delivery of services.			
Industrial relations					
Risk of any form of industrial action occurring in a way that adversely affects commissioning, service delivery or viability of the project.	Private party, may be appropriate for government to take back specific categories of risk	**RWHP** The Project Company accepts all risks relating to the Project including the risk of industrial action.	**Yes**	**Shared**	**Yes—Shared**
		The State Industrial action in relation to sharing of services such as pathology and pharmacy remain with the State.			

Auditor-General's reports

Reports tabled during 2007-08

Report title	Date tabled
Program for Students with Disabilities: Program Accountability (2007-08:1)	September 2007
Improving our Schools: Monitoring and Support (2007-08:2)	October 2007
Management of Specific Purpose Funds by Public Health Services (2007-08:3)	October 2007
New Ticketing System Tender (2007-08:4)	October 2007
Public Sector Procurement: Turning Principles into Practice (2007-08:5)	October 2007
Discovering Bendigo Project (2007-08:6)	November 2007
Audits of 2 Major Partnership Victoria Projects (2007-08:7)	November 2007
Parliamentary Appropriations: Output Measures (2007-08:8)	November 2007
Auditor General's Report on the Annual Financial Report of the State of Victoria, 2006-07 (2007-08:9)	November 2007
Funding and Delivery of Two Freeway Upgrade Projects (2007-08:10)	December 2007
Results of Financial Statement Audits for Agencies with 30 June 2007 Balance Dates (2007-08:11)	December 2007
Local Government: Results of the 2006-07 Audits (2007-08:12)	February 2008
Agricultural Research Investment, Monitoring and Review (2007-08:13)	February 2008
Accommodation for People with a Disability (2007-08:14)	March 2008
Records Management in the Victorian Public Sector (2007-08:15)	March 2008
Planning for Water Infrastructure in Victoria (2007-08:16)	April 2008
Delivering Health*SMART*—Victoria's whole-of-health ICT strategy (2007-08:17)	April 2008
Victoria's Planning Framework for Land Use and Development (2007-08:18)	May 2008
Planning Permit Application: Assessment Checklist (2007-08:19)	May 2008
Planning Scheme Amendment: Assessment Checklist (2007-08:20)	May 2008
Patient Safety in Public Hospitals (2007-08:21)	May 2008
Project Rosetta (2007-08:22)	May 2008
Results of Audits for Entities with other than 30 June 2007 Balance Dates (2007-08:23)	May 2008
Review of South East Water's Works Alliance Agreement (2007-08:24)	May 2008
Piping the System (2007-08:25)	May 2008
Implementation of the Criminal Justice Enhancement Program (2007-08:26)	June 2008
Performance Reporting in Local Government (2007-08:27)	June 2008

Report title	Date tabled
Services to Young Offenders (2007-08:28)	June 2008
Local Government Performance Reporting: Turning Principles into Practice (2007-08:29)	June 2008
Performance Reporting by Public Financial Corporations (2007-08:30)	June 2008
Coordinating Services and Initiatives for Aboriginal People (2007-08:31)	June 2008

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