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Audit summary

1.1 Introduction

1.1.1 Background

In November 2007 the Government announced that it had selected a private partner to construct a new Royal Children's Hospital (RCH), on a site immediately to the west of the current RCH site on Flemington Road in Parkville. The existing research precinct building and the front entry building will be retained and incorporated into the new complex.

The new hospital is scheduled to open in December 2011, and following RCH's relocation, much of the old site will be demolished and reinstated as parkland, replacing park land taken up for the project. The Department of Human Services (DHS) has the lead role in supervising delivery of the project.

This project is the largest hospital redevelopment undertaken by the state. The project outcomes are expected to have a major impact on the quality of tertiary health services for children in metropolitan Melbourne and other regions of Victoria.

The hospital redevelopment is being delivered as a public private partnership (PPP) in accordance with the state's *Partnerships Victoria* framework. This application of the *Partnerships Victoria* procurement model involves a private sector consortium taking responsibility for designing, building, financing, and maintaining the facility. The public sector keeps full responsibility for the clinical services delivered within the hospital.

Over the 25-year operating phase of the contract—which commences after completion of construction and successful hospital commissioning—the state will make total service payments of \$3.742 billion in nominal terms to the private sector project company. According to the 2007–08 RCH Annual Report, this was equivalent to \$1.016 billion in net present value terms, as at 30 June 2008.

In addition to the service payments over the operating phase of the hospital, the government approved:

- \$27.3 million for project management costs during the planning, procurement and construction phases of the project
- \$4.6 million for park reinstatement at the end of construction.

The government committed funding for the project on the understanding that RCH will contribute \$90 million to reduce the net cost to government of the project. RCH is expected to source this funding from fundraising, borrowings and asset sales.

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

This involved examination of:

- project planning and development documents, including the service plan and business case
- the procurement process
- contractual arrangements for the project, and documentation and data relating to the management and governance of the project.

1.2 Overall conclusion

Clear and sound advice was provided to government during the decision-making process to commit to and invest in the project. The business case was comprehensive and incorporated the key information and analysis required by *Partnerships Victoria* and other guidelines. It included transparent analysis of options, including procurement options, as well as risk and project management issues.

Service planning for the new RCH used relevant data available at the time, including the results of a model used by DHS to develop service demand projections. However, we were unable to conclude on how well that data was applied due to:

- DHS being unable to demonstrate a comprehensive understanding of the development, operation and internal logic of the forecasting model
- an absence of evidence to confirm how advice from clinicians was taken into account to enable appropriate adjustments to be made to forecasts of admitted patient activity.

The lack of a defined 'network response' for paediatric care in Victoria, and a lack of clarity about RCH's role in that network—together with delays in developing models of care for the new RCH—added to the complexity of the service planning process for the new hospital. However, this did not invalidate the planning outputs.

A competitive tender process was conducted to select the preferred consortium to deliver the new RCH project. The evaluation process at both the expressions of interest and project brief stage was well documented. The decisions were justifiable on the basis of the requirements and the selection criteria in the project brief making the process fair to all bidding parties. Relevant government requirements and guidelines were observed during the procurement process.

The state's involvement in the design and construction phase of the project is being well managed. The governance arrangements for the project provide an effective framework for communication with the relevant parties as well as assessment, monitoring and actioning of emerging issues and risks.

The project agreement includes a comprehensive performance monitoring and reporting regime for the operating phase of the new hospital. However, DHS needs to take steps to progress development of the project contract administration manual and further enhance project management documentation in place for the state's project team. Timely action on these matters will provide further assurance that the state's risks around this project are being managed effectively.

The recent downturn in global financial markets has not had any direct adverse impact on the project financing arrangements. All project finance remains in place and the state is adequately monitoring this issue.

1.3 Findings

1.3.1 Adequacy of investment planning

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

There was detailed analysis of redevelopment options and the government was given appropriate information and analysis at major decision points in the investment planning process.

A 'network response' to paediatric services in Victoria has been identified since 2002 as a key strategy to meet observed increases in service demand but the detail of the implementation process is still under consideration by DHS.

Delays in sufficiently developing models of care for the new RCH—and the absence of a defined network approach to paediatric care in Victoria—at the time of service planning added to the complexity of the planning process for the new hospital. However this lack of a strategic framework did not invalidate the planning outputs.

Clarity around models of care and the RCH role in the wider health network are significant for service planning as they:

- assist in defining the service delivery approach
- inform the forecasting for service demand
- ultimately define the design parameters and facility requirements for a new hospital.

Models of care were sufficiently developed by the project brief stage and continue to evolve.

Service demand for the new RCH was projected using a forecasting model. There was limited evidence to show clinician involvement in adjustments made to overcome a number of known limitations of the model.

The forecasts of future service demand in the RCH service planning process were based on a declining birth rate forecast made by the Australian Bureau of Statistics (ABS). This was the most appropriate and up-to-date data source available at the time. However, more recent ABS data indicates that the actual birth rate increased in Victoria over the period 2001 to 2005.

The new RCH has 50 more beds than the existing RCH and DHS has demonstrated that this greater capacity—together with the inherent flexibility and potential capacity for growth in the design of the new RCH—should handle currently projected increases in service demand.

However, DHS has not yet determined, or advised government, when this additional future capacity may need to be taken up.

1.3.2 Assessing value offered by the private sector bids

A competitive tender process was used to select the preferred consortium to deliver the project. An appropriate evaluation framework, incorporating a value for money approach, was in place to evaluate the bids.

Effective tools were employed to assess value for money during the procurement process, including the Public Sector Comparator (PSC), which is a theoretical estimate of the cost of the most efficient public sector procurement model. The net present cost of the bids was compared to the PSC cost in order to determine whether the project could deliver better value for money if conducted under a *Partnerships Victoria* structure.

Other qualitative value for money tests were also applied during the procurement evaluation, including a public interest test.

The planned timelines for the procurement process were met, which was a significant achievement, given the scale and complexity of the project and procurement task.

The procurement approach complied with the expected elements of Victorian Government Purchasing Board policy and guidance and the *Partnerships Victoria* guidelines, and was adequately documented. In particular, the following were 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 the required approvals were obtained
- the evaluation of the bids was undertaken against previously determined criteria stipulated in the evaluation plan.

The risk allocation in the project agreement is also broadly in line with *Partnerships Victoria* guidelines with no significant departures.

1.3.3 Supervision of delivery of infrastructure and services

The state is adequately managing its involvement in the design and construction phase of the project. However, development of the contract administration manual needs to be progressed and project management documentation needs enhancement to provide greater assurance about effective management of the state's project risks.

Appropriate governance structures have been established for the project. The state's actual project costs are also expected to be within approved budget limits.

The construction schedule is on target and the independent reviewer appointed for the project has recently reported that the project remains on track for the 21 September 2011 technical completion milestone.

The impact of the downturn in global financial markets on the project is being actively monitored. All debt and equity funding for the project—approximately \$1.38 billion—was contributed in December 2007 and remains in place, in authorised investments.

However, due to the impact of the recent global financial market downturn, a promised donation to RCH of \$35 million from the original private equity sponsor is now much less certain.

The project agreement adequately defines the services to be delivered by the project company during the operating phase of the new hospital and includes a comprehensive performance monitoring and reporting regime.

1.4 Recommendations

It is recommended that:

- DHS should develop and define models of care beyond high level statements at the service planning and business case stages for any future major hospital investments. This will help to make sure that investment decision-making processes are better informed by the service delivery strategy expected to be adopted. **(Recommendation 4.1)**
- DHS develop a comprehensive understanding of its service demand forecasting model—which is a statewide and not hospital specific forecasting tool. This will help DHS to better understand the model's limitations and impacts when forecasting demand for future service delivery. **(Recommendation 4.2)**
- DHS expedite the development of a strategic 'network response' framework for the future development of paediatric health services in Victoria. **(Recommendation 4.3)**
- RCH consider the implications of a strategic 'network response' framework for the future development of paediatric health services in Victoria when finalising its current service plan review. **(Recommendation 4.4)**
- DTF amend its guidance to require that agencies implementing *Partnerships Victoria* projects:
 - conduct and document quality assurance reviews of PSC estimates and related financial models—irrespective of whether they are internally or externally prepared—to reduce risks of error or inaccuracy, and to ensure that the state has sufficient understanding of these highly complex financial models
 - maintain adequate documented evidence to support all costings and PSC calculations contained in a business case. **(Recommendation 4.5)**

- DHS and RCH should promptly execute a memorandum of understanding setting out their respective responsibilities in relation to the project. **(Recommendation 6.1)**
 - DHS should complete and endorse the RCH contract administration manual and address observed gaps and weaknesses in project management documentation as a priority. **(Recommendation 6.2)**
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