The top ten risks that auditors should be aware of when reviewing the operational phase of PFI schemes

While organisations such as the NAO have examined many PFI (Private Finance Initiative) projects, little guidance has been available to help public sector internal auditors review those projects that are in the operational stage. Therefore, earlier this year, CIPFA published a 'Practical Guide to the Internal Audit of the Operational Phase of PFI Projects' in an attempt to bridge the gap.

Shortly after publication, we asked the authors, David Catterall of CEAC and Steve Wood of NHS Wales, for what they saw as being the main risks that they think auditors should consider when reviewing operational PFI projects. This is what they gave us:

1. **Inadequate preparation**
   Contract monitoring may be ineffective due to insufficient planning for the staffing of the public sector organisation's contract monitoring team. Additionally there may be overspends because the budget for contract monitoring was inadequate in the original business case.

2. **Poor project governance arrangements**
   Increased cost, delays, excessive payments, and/or poor levels of service delivery may be allowed to continue undetected due to an ill-defined project governance structure and/or non-retention /poor accessibility to key information/reports.

3. **Lack of communications plan**
   A lack of a well-managed and well-defined stakeholder communication plan may impede the likelihood of a successful implementation of the project. An adequate plan should take account of the likelihood that the PFI project will have a large range of users who will change over the life of the contract. It is essential that the communications plan addresses continuity planning; together with taking the opportunity to update and train users.

4. **Lack of clarity and understanding of performance requirements by either the PFI contractor (PFI Co) and/or the public sector organisation**
   There may be poor performance due to the output specification and the levels and terms under which the service should be provided not being clearly defined. Additionally the public sector organisation and the PFI Co may not understand what key performance indicators/targets have to be met.

5. **Lack of understanding by PFI Co and the public sector organisation of their respective responsibilities for monitoring services**
   The project agreement fails to prescribe the detailed responsibilities of the PFI Co for monitoring services, and/or the rights of the public sector organisation to inspect the facilities, including the PFI Co's records, and to report any actual/potential service failures. In addition, where such obligations are satisfactorily prescribed they may be ineffectively implemented.

6. **Ineffective operation of performance management and monitoring systems**
   Poor performance may be undetected due to the PFI Co not operating effective systems and procedures for managing and reporting on performance. Also, the client role may be weakened due to inadequate resources being available for monitoring the performance of the PFI Co's service providers under the contract.

7. **Incorrect monthly payments by the public sector organisation to the PFI Co due to inaccurate information regarding performance and service failures**
Procedures fail to ensure that any financial deductions are verified as being in accordance with agreed performance information and monitoring checks made by the public sector organisation. Payments should only be made based on confirmation of satisfactory performance, i.e. commensurate to the performance actually delivered.

8. **Poor control of change management (variations) procedures**
Inappropriate variations may be authorised due to poor evaluation by the public sector organisation of the potential financial and operational consequences of a proposed change. Poor value for money may result from a poor procurement procedure. There may be abortive costs and wasted time due to failure to identify funding for changes.

9. **Benchmarking and market testing exercises not performed or results not implemented**
Benchmarking and market-testing procedures that are inadequate or poorly designed and/or operated will leave the public sector organisation exposed to operational and/or financial risks. There is a need to ensure that service specifications remain fit for purpose and confirm that value for money is obtained from all the PFI services. The outcomes of benchmarking and market-testing procedures must be fully implemented to derive the full benefits of the exercise.

10. **Lack of ongoing Post-Project Evaluation procedures**
If effective post project evaluation exercises are not conducted on the implementation of the operational stage of a PFI project there will be risks that lessons may not be learned; required remedial actions may not be implemented; the 'informed client' role may not be effectively discharged and, over time, poor value for money may be delivered.

David and Steve stressed that their response to us did not consider the debate on the merits or otherwise of the Private Finance Initiative, which are currently being reviewed by HM Treasury. Rather, it was to concentrate on the successful implementation or otherwise (within the defined objectives for a respective project) of the various deals (good or bad) that have been struck by the public sector.

April 2012