

## 8.

### EDUCATION AND CULTURE - PUBLIC-PRIVATE PARTNERSHIPS (P3s) FOR SCHOOL CONSTRUCTION

#### BACKGROUND

**8.1** In the April 17, 1997 Budget Address to the House of Assembly, the Minister of Finance stated

*“Every new school in Nova Scotia will be built through public-private partnerships. This means more schools will be built more quickly with leading-edge technology. Seven of these schools are now in various stages of planning and construction. Over the coming year, government will outline details of the next round of new school construction.”* (Budget Address to the Nova Scotia House of Assembly for the fiscal year 1997-98, page 15)

**8.2** This represents a fundamental shift in the way in which schools are designed, constructed, financed, owned and operated in Nova Scotia.

**8.3** The following paragraphs include background information which we believe is necessary to understand the issues associated with this transition including:

- the objectives of the public-private partnership (P3) process for school construction;
- the history of school construction financing in Nova Scotia; and
- the recommendations of the Canadian Institute of Chartered Accountants relating to accounting for leases and their impact on the financial statements of the Province.

**8.4** Chapter 3 of this Report includes additional information which is also relevant to understanding the related issues such as:

- the concept of public-private partnerships (page 28);
- the Cooperative Business Solutions (CBS) procurement process (page 25); and
- the administration of the P3 process within the government of Nova Scotia (page 29).

#### *Objectives for P3 Schools*

**8.5** The Department of Education’s objectives for P3 schools are described in the Department of Finance Discussion Paper *Transferring Risk in Public/Private Partnerships November 1997* as follows:

*“Schools delivered via a Public Private Partnership will be flexible, high tech learning environments to support programs and services for students during the useful life of the school. All technology will be integrated and provide valuable support tools for students and professional staff.”*

*These schools will be connected electronically to neighbouring schools so that equitable access to technology is accomplished.*

*The Private Sector will refresh the technology, and refreshed technology will be provided to other schools in the region.*

*One of the objectives of Public/Private Partnerships is to ensure participatory planning for the facility to accommodate programs and services both now and in the future. Students, staff, School Board, the Province, the community at large and the Private Sector are involved in the design and construction of the facility.” (page 4)*

**8.6** In addition to Education’s objectives, the Department of Finance has put forward objectives for P3 arrangements in the same publication.

*“From the perspective of the Department of Finance, the main objective for P3 is to use it as a mechanism to deliver selected services efficiently and cost-effectively so as to:*

- attract private capital to the Province’s public initiatives, thereby requiring less investment of public money;*
- transfer expertise to the private sector, thereby creating economic opportunities in the private sector, i.e., increased private sector job creation via increased sales, both external and internal to Nova Scotia;*
- enable the government to devote more of its resources to its “core business,” the delivery of essential services;*
- transfer risk to the private sector where this can be done in a cost-effective manner; and*
- realize a net increase in value for public expenditures.” (page 4)*

**8.7** Although not explicitly stated in *Transferring Risk in Public/Private Partnerships November 1997*, the Department of Education and Culture also has the objective of leveraging the annual appropriation available for school construction to fill as many of the urgent school construction requests from school boards as possible.

### ***History of School Construction Financing in Nova Scotia***

**8.8** In the past, schools were constructed by the Department of Transportation and Public Works (formerly the Department of Supply and Services). Financing was obtained through debentures issued by the Nova Scotia Municipal Finance Corporation. When construction was complete, title to the school would be transferred to the school board and the asset and the related debt owing to the Municipal Finance Corporation would be recorded on the board’s financial statements. The Department of Education and Culture would make capital debt assistance grants to the boards over the life of the debt. The grants were equal to 100% of the required payments on the debt and would be recorded as expenditures of the Province when paid.

**8.9** In March 1993, to comply with pronouncements of the Canadian Institute of Chartered Accountant’s (CICA) Public Sector Accounting and Auditing Board, school debt was recorded in the Public Accounts for the first time. The CICA’s recommendations reflect the position that financial statements of a government should include all of its liabilities at the end of the accounting period. The Province’s liabilities and net debt were increased by \$217 million at March 31, 1993 to reflect this change in accounting policy.

**8.10** The other effect of this change in accounting policy was that 100% of the cost of new schools would be expensed when the school was built. This new accounting treatment was consistent with that used for any other Provincial capital asset.

**8.11** While the change in accounting policy was one important aspect of the history of school construction in this Province, there was a second important change at approximately the same time.

**8.12** In 1992, Executive Council approved a new school construction prioritization process which included:

- requests for submissions from school boards;
- evaluation by a committee comprised of various stakeholders including school boards;
- pre-determined evaluation criteria; and
- a recommendation that \$30 million be set aside annually for school capital construction to address the projects in the high priority category over the next three years.

**8.13** The following shows the actual school construction expenditures of the Department of Education and Culture for the years 1992-93 to 1997-98.

**Department of Education and Culture  
School Construction Expenditures (\$ millions)**

Year	
1992-93	\$54.6 - debt service grants
1993-94	\$13.0 - old construction program \$2.0 - new construction program
1994-95	\$12.4 - old construction program \$6.0 - new construction program
1995-96	\$7.0 - old construction program \$17.6 - new construction program
1996-97	\$4.0 - old construction program \$38.4 - new construction program
1997-98	\$33.4 - Estimate

**8.14** Fiscal restraint reduced the amount available for new school construction below the \$30 million recommended by the committee. However, the demand for school construction from the public was great. It appears that the increasing public demand, combined with the Province's inability to devote required resources to this area, led directly to the exploration of public-private partnerships for school construction as a solution.

**8.15** The Department of Education and Culture’s estimates for the 1996-97 and 1997-98 fiscal years included \$.4 million and \$2.56 million, respectively, related to school lease payments.

**8.16** In December 1997, Executive Council approved the school construction priorities identified in the *Report of the School Capital Construction Committee* dated September 1997. The total value of the schools and repairs called for in the Report is approximately \$360 million of which \$250 million relates to new school construction. The government plans to invest approximately \$25 million annually in P3 leases to permit an immediate start to the school planning process.

### ***Impact on the Province’s Financial Statements***

**8.17** The Canadian Institute of Chartered Accountants (CICA) issues accounting standards for profit-oriented businesses and not-for-profit organizations in its Handbook. The CICA’S Public Sector Accounting and Auditing Board (PSAAB) issues Recommendations and guidance with respect to matters of accounting and auditing in the public sector. PSAAB has not yet issued recommendations on accounting for leases in public-sector organizations. In the absence of specific public-sector accounting recommendations, the CICA Handbook becomes the source of professional guidance in accounting for leases.

**8.18** The CICA Handbook distinguishes two separate methods of accounting for leases depending on the terms and conditions of the specific lease. It includes guidelines for determining whether a lease should be categorized as operating or capital. The overriding principle is that the accounting for the lease should be based on its substance rather than its form. However, we acknowledge that these quantitative guidelines have tended to be applied strictly as “rules” in both the public and private sectors which might result in different accounting treatment than if the substance of a transaction had been appropriately considered.

**8.19** Note that evaluation of the substance of an arrangement may include documents other than the actual lease. If other agreements covering certain aspects of the arrangement, such as the operation of the school or the renewal of technology, are an integral part of the public-private partnership then they should also be considered when deciding on appropriate accounting treatment.

**8.20** A *capital lease* is a lease that, from the point of view of the lessee, transfers substantially all the benefits and risks incident to ownership of property to the lessee. An example of a capital lease would be one where ownership of the asset at the end of the lease term is virtually assured of transferring to the lessee. For example, if the lease included a bargain purchase option at the end of the lease term it would be classified as a capital lease. A capital lease would be accounted for by the lessee as an acquisition of an asset and an assumption of an obligation to reflect the substance of the transaction in the year in which the lease was signed. *In the Province’s financial statements, classification as a capital lease results in 100% of the cost of a leased asset being recorded as an expenditure and a liability when the lease is signed.*

**8.21** An *operating lease* is a lease in which the lessor does not transfer substantially all the benefits and risks incident to ownership of property. Lease rentals under an operating lease should be included in the determination of net income over the lease term on a straight-line basis. *In the Province’s financial statements, classification as an operating lease results in payments being recorded as expenditures when incurred.*

**8.22** *The impact of the accounting principles governing lease accounting is significant. If the school leases can be accounted for as operating leases, then the Province can leverage the resources available to build schools and acquire use of more new schools within the appropriation voted by*

*the House of Assembly. If the school leases include terms and conditions that require accounting as a capital lease, then the Province loses the ability to leverage the appropriation to acquire the use of more schools.* Paragraph 8.16 illustrates how the Province plans to leverage an annual appropriation of \$25 million through use of operating leases to provide schools with a construction cost of \$250 million.

## RESULTS IN BRIEF

**8.23** The following are the principal observations resulting from our audit:

- As of the date of writing this Report (December 1997) the Province had not signed leases for any of the eight P3 schools although two schools were occupied. Memorandums of Agreement for two schools (O'Connell Drive and Hants East Middle) were submitted to Executive Council in December 1997 and negotiations on final leases for other schools were proceeding. Government is making changes to ensure that costs are finalized before construction starts for future schools.
- The government did not prepare a formal analysis of the advantages of P3 arrangements in comparison to the traditional approach prior to making the decision to enter into P3 arrangements for school construction. We recommend that government prepare a detailed analysis of risks and rewards prior to entering into any future public-private partnership arrangements.
- The degree of success which the Province has achieved in transferring the risks associated with P3 schools to the private sector cannot be evaluated until the lease arrangements (including operating agreements and technology refreshment) are finalized.
- The Province has stated that school leases will not be signed unless they can be classified as operating leases under CICA guidelines. This will enable the Province to leverage the resources available to build schools and acquire use of more new schools within the appropriation voted by the House of Assembly. In December 1997, the Province announced plans to use an annual appropriation of \$25 million to make payments on operating leases related to \$250 million of new school construction. The requirement for an operating lease precludes consideration of certain lease provisions which might have been advantageous to the Province in obtaining value-for-money. Until the leases and other agreements are finalized, we cannot evaluate the value-for-money included in the arrangements or whether the proposed accounting treatment is appropriate.
- The Province has been making advances to the P3 consortiums to finance the school construction process. The advances were made on the basis of approved progress claims with certification of the work performed. Management of the Departments of Education and Culture and Finance provided us with a legal opinion indicating that the Departments had "*sufficient statutory authority for these expenditures*" because the lease payments were included in annual appropriations. However, we believe that the Education Act is not clear with respect to the authority of the Minister in relation to P3 schools other than the right to approve plans for school buildings. Executive Council approved the Reports of the School Capital Construction Committee in which each of the P3 schools were listed as priorities but no Orders in Council were issued to approve specific construction and public-private

partnership arrangements. We recommend that the legislation be clarified to indicate the type of approval required (Minister or Executive Council) for P3 agreements and construction advances.

- As one of its March 31, 1996 year-end accounting adjustments, the Department of Education and Culture created a Trust Fund of \$1.7 million for Sherwood Park Education Centre in Sydney from its 1995-96 capital appropriation. The amount was charged against the Department's 1995-96 appropriation although it will be used to fund expenditures of future years.
- We cannot conclusively state that construction of P3 schools is more or less costly than traditional schools due to the many factors involved in such a comparison, and the variation in estimates impacting such an analysis. For example, the Horton construction agreement included an estimate of \$28.9 million which was subsequently reduced to \$27.0 million and again reduced to \$25.5 million in December 1997. Department management has provided an explanation for the reduced estimate but we are unable to determine the accuracy of the estimate until construction is complete. Exhibit 8.3 provides information sufficient to enable the reader to compare certain aspects of the costs of these schools but financing, operating and other costs to be incurred over the life of these schools are not included.
- Monitoring and evaluating P3 arrangements both during and after implementation is important and we encourage government to establish an appropriate process to monitor and evaluate P3 schools which is independent of those with responsibility for the P3 initiative.
- On December 11, 1997 the Priorities and Planning Secretariat released *Partnerships & School Construction: A Review* which makes several recommendations to improve government control over P3 school construction initiatives. Implementation of the recommendations of the Review will improve controls over certain aspects of the process but will not address all of our concerns. For example, the Review does not include a comprehensive analysis of the costs and benefits of leasing versus ownership of schools. The impact of operating leases on the long-term provision of education to students in the Province and the Province's current and future financial position and operating results is significant. Operating leases will result in the ownership of the schools resting with the private sector at the end of the lease term and the costs and benefits of such leases merit thorough consideration.

## AUDIT SCOPE

**8.24** The objectives of this audit were to examine:

- any analysis prepared by the Department of Education and Culture to support the decision to enter into P3 arrangements for school construction;
- the selection process for private-sector partners in order to evaluate compliance with government procurement policies;
- the accounting treatment of any school leases and interim financing arrangements for compliance with generally accepted accounting principles and the Province's stated accounting policies;

- any agreements with private-sector partners to determine whether they incorporate due regard for economy and efficiency; and
- any agreements with private-sector partners to understand the nature of risk transferred from the public sector to the private sector.

**8.25** The following general criteria were used in our audit.

- Prior to making the decision to enter into P3 arrangements, the Department should formally analyse the risks, costs and benefits of P3 school financing and construction versus the traditional method.
- The selection of private sector partners for school construction should comply with government procurement policies.
- Accounting should comply with generally accepted accounting principles and the Province's stated accounting policies.
- Key terms and conditions including design, construction, financing and operating agreements should be documented in formal agreements prior to the start of construction.
- P3 arrangements should incorporate due regard for economy and efficiency.
- P3 arrangements should result in transfer of risk to the private sector.

**8.26** Our audit approach was based on discussions with management of the Departments of Education and Culture and Finance and examination of documentation provided. For our audit of the procurement process, we examined detailed documentation associated with the Sydney school only.

## PRINCIPAL FINDINGS

### *Status of P3 School Construction Initiative*

**8.27** There are eight P3 schools. Exhibit 8.1 summarizes the current status of those schools.

**8.28** As of the date of writing this Report (December 1997) the Province had not signed leases for any of the schools. Memorandums of Agreement for two schools (Porters Lake and Hants East Middle) were submitted to Executive Council in December 1997 and negotiations on final leases for all schools were proceeding.

### *Analysis to Support the P3 Decision*

**8.29** As mentioned previously, the decision to enter into P3 arrangements for schools represents a fundamental shift in the way in which schools are designed, constructed, financed, owned and operated in Nova Scotia. We expected that the government would have undertaken a thorough analysis of the advantages of P3 arrangements in comparison to the traditional approach prior to making this significant decision, and that there would have been appropriate documentation prepared to support the analysis. In our opinion, this type of analysis is necessary to:

- ensure that the potential risks and rewards of the alternatives have been considered; and
- act as a benchmark when evaluating the effectiveness of a new policy after it has been implemented.

**8.30** The government did not prepare a formal analysis prior to making the decision to enter into P3 arrangements for school construction. We recommend that government prepare a detailed analysis of risks and rewards prior to entering into any future public-private partnership arrangements.

### ***Procurement Process***

**8.31** The conventional model of school construction in the Province was Design-Bid-Build whereby the Department of Supply and Services would procure the services of an architectural firm to design the school. After a design was agreed upon, the Department would request proposals for construction.

**8.32** The John C. Wickwire school in South Queens, opened in September 1997, used a variation of the conventional approach which was termed Design-Build. This approach involved a single request for proposals for both design and construction services. The procurement approach used for that school was more similar to the P3 approach which included a single request for proposals for all phases of the project - design, construction, financing and operation.

**8.33** The procurement process for P3 schools was based on the Co-operative Business Solutions (CBS) procurement methodology as described in Chapter 3 of this Report (page 25). As noted in Chapter 3, page 25, CBS is a procurement method whereby a supplier is selected, on the basis of qualifications and capability rather than price, to form a business alliance of shared risks, resources and benefits between the supplier and government. Cost is negotiated after the preferred supplier is selected.

**8.34** The procurement process generally consisted of the following:

- There was a public call for expressions of interest for each school (Phase I).
- Expressions of interest were evaluated by a committee with broad representation, and a short list was developed.
- Those on the short list were asked for detailed proposals (Phase II).
- The detailed proposals were evaluated by a committee with broad representation.
- A private-sector partner (preferred supplier) was selected.
- Costs and leases were to be negotiated in Phase III of the selection process.

**8.35** We examined the procurement process related to Sherwood Park Education Centre in Sydney to determine if it complied with the process described to us, and concluded that it was compliant in most respects.



**8.36** The process for the Sydney school was competitive. The call for expressions of interest took place in July 1994. The Call for Expression of Interest stated that “*Phase I evaluations will focus on experience, technical competence, managerial ability and proven performance, as well as a vision of the proponents solution.*”

**8.37** Seventeen proposals were received and evaluated by a committee with membership from the Departments of Supply and Services, Finance, and Education and Culture and the Cape Breton District School Board. The three proponents scoring highest in the evaluation were then requested to submit detailed proposals by October 1994 and those proposals were also evaluated by the committee on the basis of pre-determined criteria which had been previously circulated to the proponents.

**8.38** For Phase II of the Sydney selection process, proponents were required to submit cost estimates along with their proposed design for the Centre. Cost estimates were not required for subsequent P3 schools as preparation was deemed to be a costly exercise, and costs were subject to change if the design for the school was modified at a later stage. Submission of cost information is not usually part of the CBS process.

**8.39** The *Report of the Sydney Junior High School Private/Public Partnership Committee* was issued on December 19, 1994. It included the following conclusion:

*“Each of the three proponents are technologically capable of carrying out the project and so, as can be expected, the scores are relatively close. The evaluation team noted that none of the three finalist proponents met with their expectations absolutely. The team also noted that the costs, as projected in the proposals, are in all cases higher than carrying out the project in a conventional way. However, the team believes that negotiations with the private sector partner(s) will result in value for money and a lower overall cost.”* (page 4)

**8.40** The Report included the following three recommendations:

*“The Evaluation Team recommends that:*

- 1. The province approve of the team commencing negotiations with [the proponents who scored first and second in the evaluation] in an attempt to reach a more favourable financial arrangement.*
- 2. The team identify the most favourable financial arrangement and make an appropriate recommendation to the province.*
- 3. If a favourable financial arrangement is negotiated by the team, work begin immediately to have the facility designed, built, financed and operated by a private sector partner.”* (page 4)

**8.41** Subsequent to the issue of that Report, the third ranking proponent was advised that they were not successful and a smaller committee was formed to begin detailed negotiation with the two remaining proponents. The smaller committee included the Deputy Ministers of Finance and Education and Culture and the Superintendent of the Cape Breton District School Board. The decision of the smaller committee was conveyed to Executive Council for information in a Memorandum to Cabinet from the Minister of Education and Culture. In April 1995, TR3LC were informed that they were the successful proponent in a letter signed by the Deputy Minister of Education and Culture.

**8.42** Costs and leases were to be negotiated and finalized in Phase III of the CBS process. Those involved in the process hoped that arrangements could be finalized prior to the start of construction, or shortly thereafter, but negotiations took longer than anticipated and are still ongoing. Implementation of the recommendations in the Priorities and Planning Secretariat's recently released *Partnerships & School Construction: A Review* (see paragraph 8.63) will ensure that costs are finalized before construction starts for future schools. That Review includes the following recommendations:

*"No construction contracts for any new projects should be executed until financing is in place and leases are signed. Leases are to be public documents...The two lead departments...should...prepare Requests for Proposals that include clear financial bottom lines including the total overall cost of each project..."* (page 7)

### ***Participatory Planning Process***

**8.43** One of the Department of Education and Culture's stated objectives for P3 schools is participatory planning as described in paragraph 8.5 above. We visited Sherwood Park Education Centre in Sydney and found it to be a unique, functional school which gives the school community access to current technology. During that visit, we were told that the school represents the first time that teachers and members of the community were given formal input into the school planning process. This was achieved through consultations carried out by the successful proponent.

**8.44** We believe that participatory planning processes could be carried out as part of the traditional school construction process as well as under P3 arrangements. The government conducts planning based on consultation in other sectors and could have incorporated this approach in the traditional school construction process. The Department maintains that the private sector consortiums can carry out participatory planning more economically than government but the Department did not provide any analysis to support its position.

### ***Efficiency of the Construction Process***

**8.45** The Department of Education and Culture believes that P3 school construction is more efficient than the traditional approach. For example, the construction period for the Sydney junior high school was nine months (from April 1996 to opening in January 1997). We believe that the amount of time required to build a school varies with the quantity and nature of resources devoted to the task, and the manner in which the project is managed. Therefore, it should be possible to increase the efficiency of the traditional school construction process to meet construction targets. The private sector has been involved with school construction in the Province for many years as project contractors and should be able to meet construction targets set out by the Department whether the arrangement is structured under traditional lines or as a P3.

### ***Requirement for Operating Leases***

**8.46** The Departments of Education and Culture and Finance have been negotiating with the successful consortiums over a lengthy period but, to date, no leases have been signed. The Province and its private-sector partners have not been able to agree on lease terms which qualify for treatment as an operating lease under the CICA guidelines (see paragraph 8.21 above). If the school leases can be accounted for as operating leases, then the Province can leverage the resources available to build schools and acquire use of more new schools within the appropriation voted by the House of

Assembly. If the school leases include terms and conditions that require accounting as a capital lease (see paragraph 8.20 above), then the Province loses the ability to leverage the appropriation to acquire the use of more schools. An annual amount of \$30 million for school costs can make lease payments on a number of schools if the leases are structured as operating leases, rather than cover the entire costs of just one or two new schools if the leases are structured as capital leases.

**8.47** Structuring the leases as operating leases results in the current government making commitments that will govern the level of spending for the Department of Education and Culture for school construction for a number of years. The term of the leases is likely to be in the range of 20 years. As more schools are constructed through P3's, the Province's commitment of annual payments becomes larger and the flexibility, therefore, to construct new schools (and take on additional financial commitments) in the future is reduced.

**8.48** Similarly, if all the operating leases expire at almost the same time, the Province may be left with a shortage of schools and forced to renew the leases at less than advantageous terms. Management of the Department of Education and Culture has indicated that operating leases provide more flexibility because of the option to not renew the lease thereby shifting occupancy risk to the private sector. The impact of operating leases on the long-term provision of education to students in the Province is an important factor when making the decision on appropriate lease terms.

**8.49** We believe that introducing the requirement for these leases to be eligible for treatment as operating leases into the lease negotiations may impact the value-for-money inherent in the final lease agreement. The requirement for an operating lease precludes consideration of certain lease provisions which are inconsistent with classification as an operating lease. For example, the government would not consider a bargain purchase option to be an acceptable component of the final agreement because it would eliminate a lease from treatment as an operating lease.

**8.50** Management of the Departments of Education and Culture and Finance believe that introduction of the requirement for an operating lease to the negotiation process leads to consideration of a broader range of alternatives and, ultimately, better value for taxpayers. Until the leases and other agreements are finalized, we cannot evaluate value-for-money inherent in the arrangements or whether the proposed accounting treatment is appropriate.

### ***Risk Transfer***

**8.51** The government has stated that risk transfer to the private sector is an objective for P3 arrangements (see paragraph 8.6 above). The November 1997 Department of Finance Discussion Paper *Transferring Risk in Public/Private Partnerships* discusses a number of risks that could potentially be transferred to the private sector. For P3 schools, the Discussion Paper identifies the following risks:

- *Residual value risk* - the risk associated with ownership of a school building (including its residual value).
- *Occupancy risk* - the risk that the utilization rate of a facility will be more or less than expected during all, or part, of its life.
- *Operating (availability and performance) risks* - the risk associated with the operations of school buildings under P3.

- *Planning risk* - the risk that a proposed project may not meet the required standards or community needs throughout its life.
- *Design and construction risk* - the risk of cost overruns, construction delays, or design and construction flaws.
- *Regulatory and legislative risks* - the risk that a project's viability will be affected by changes in legislation.

**8.52** The Discussion Paper focuses on strategies for transferring appropriate risks to the private sector partner. As indicated in the Paper "*The essence of a truly beneficial public/private partnership is the transfer of risk from one partner who has difficulty dealing with the risk to another partner who is better equipped to deal with it.*" (page 1)

**8.53** The degree of success which the Province has achieved in transferring the risks associated with P3 schools to the private sector cannot be evaluated until the lease arrangements are finalized. This includes the formal lease agreements and agreements governing any other aspects of the P3 schools including school operations and technology refreshment over the lease term.

#### ***Interim Financing of Construction Costs***

**8.54** The inability of the Province to finalize leases could have led to delays in starting construction because the consortiums could not obtain financing for construction costs without signed leases to be used as collateral. The Province lent funds to the consortiums to avoid construction delays. Fixed construction costs were agreed upon, in advance, between the Province and the partners and funds were advanced on the basis of the fixed costs.

**8.55** The advances were to be made on the basis of approved progress claims with external certification of the work performed. The process was similar to the one used in the past for schools constructed by the Department of Supply and Services. For Sydney, the firm which performed the certification of work performed was part of the consortium. This was recognized by the Department of Education and Culture as an aspect of project control that could be improved and it was corrected in subsequent schools by having the certifier employed by the Department.

**8.56** The advances were accounted for as accounts receivable from the consortiums. The Department's plan was that the leases would be signed in the near future which would allow the consortiums to obtain bank financing. When financing was obtained, the consortiums would repay the debt to the Province.

**8.57** As at March 31, 1997 there were no leases signed. The Province had an account receivable of \$14.8 million from the consortiums related to the Sydney and Porters Lake schools. Of the \$14.8 million, \$11.9 million related to Sydney and \$2.9 million related to Porters Lake. The Sydney receivable was 85% of the total expected construction cost of the school, and the Porters Lake receivable was 41% of the total expected construction cost of the school.

**8.58** The Province decided to expense the advances on the March 31, 1997 financial statements. The stated rationale was that the Province was uncertain of being able to negotiate acceptable lease agreements for these schools in the future and, accordingly, decided to recognize the uncertainty with respect to the accounts receivable. The expenditure was recorded as a capital expenditure of the Department of Education and Culture for the year ended March 31, 1997 and was approved by an additional appropriation in April 1997.

**8.59** We asked the Departments of Finance and Education and Culture for information relating to the specific legislative authority under which the advances to the consortiums were made. The advances were approved by management of the Departments of Education and Culture and Finance. Management of the Departments of Education and Culture and Finance provided us with a legal opinion indicating that the Departments had “*sufficient statutory authority for these expenditures.*” This conclusion was based on the opinion that the advances were made under the authority of the Department of Education and Culture’s annual appropriation provided in the Appropriations Act, 1996. Note that this appropriation included authority for lease payments, not advances.

**8.60** The Education Act does not specifically give the Minister the authority to make advances for school construction. Section 141 states:

“*The Minister may...*

- (f) after consultation with a school board, approve plans for school buildings;...*
- (l) do such other things as the Minister deems necessary to carry out effectively the Minister’s duties under this Act.”*

**8.61** When schools were constructed by the Department of Supply and Services (DSS), the Minister of Education obtained an Order in Council which included approval of the specific construction project and authority for the Ministers of Education and DSS to “*execute such instruments as may be necessary*”. Other Departments must seek OIC’s to approve advances to individuals and corporations as required by legislation. Executive Council approved the Reports of the School Capital Construction Committee in which each of the P3 schools were listed as priorities but no Orders in Council were issued to approve specific construction and public-private partnership arrangements.

**8.62** The Education Act is not clear with respect to the authority of the Minister in relation to P3 schools other than the right to approve plans for school buildings. We recommend that the legislation be clarified to indicate the type of approval required (Minister or Executive Council) for P3 agreements and construction advances.

### ***Review by Priorities and Planning Secretariat***

**8.63** In October 1997, the Premier requested senior officials from the Priority and Planning Secretariat and other agencies of government to review the P3 school construction process to date. The purpose of the review was to “*provide analysis of the process to date, including discussion of any shortcomings, recommendations as to whether or not the process should proceed, and recommendations as to possible safeguards that might allow for a process of school capital construction involving the private sector to go forward.*” (*Partnerships & School Construction: A Review*, page 1)

**8.64** On December 11, 1997 the Priorities and Planning Secretariat released *Partnerships & School Construction: A Review* which makes several recommendations to improve government control over P3 school construction initiatives including:

- “*No construction contracts for any new projects should be executed until financing is in place and leases are signed. Leases are to be public documents.*
- *No financing or other partnering arrangements should be accepted without the prior approval of the Priorities and Planning Committee and Executive Council.*

- *Future projects for school construction should follow a clearly defined process. The two lead departments, Transportation and Public Works and Education should:*
  - ▶ *determine priority order for projects*
  - ▶ *obtain cabinet approval*
  - ▶ *prepare Requests for Proposals that include clear financial bottom lines including the total overall cost of each project,*
  - ▶ *report back to cabinet for approval on selection of private sector partners,*
  - ▶ *submit all leases to cabinet for approval prior to proceeding*
  - ▶ *ensure public tendering on the construction contract(s) for the project,*
  - ▶ *oversee completion of specific projects, and*
  - ▶ *administer all aspects of lease arrangements.” (page 7)*

**8.65** Implementation of the recommendations of the Review will improve controls over certain aspects of the process but will not address all of our concerns. For example, the Review does not include a comprehensive analysis of the costs and benefits of leasing versus ownership of schools.

### ***1996 Trust Fund***

**8.66** As one of its March 31, 1996 year-end adjusting accounting entries, the Department of Education and Culture created a Trust Fund in the amount of \$1.7 million for the Sydney school. The Fund was set up from the Department’s 1995-96 capital appropriation which included an unexpended amount for the Sydney school. The trust was established in the name of the Cape Breton District School Board with the signing officers being two members of management of the Department of Education and Culture. During the 1996-97 year, \$1.3 million of the Fund was advanced to the private-sector partner for the Sydney school and is included in the amount which is planned to be recovered from the consortium when the lease is signed. The remaining \$.4 million is still in the Fund. Our concern is that \$1.7 million was charged against the Department’s 1995-96 appropriation although it is to be used to fund expenditures of future years.

### ***Benchmarking/cost Comparisons of P3 Projects with Similar Schools***

**8.67** The issue of the relative costs of P3 and traditional schools has been discussed in the House of Assembly and reported in the media. We believe that it is not possible to perform a conclusive comparison of the total costs and benefits of P3 schools until all related arrangements are finalized. These arrangements include the terms and conditions governing design, construction, ownership, financing and operation of the school buildings and related technology.

**8.68** However, the Province engaged a firm of quantity surveyors (Hanscomb Consultants Inc.) to perform a comparative analysis of school construction costs for P3 schools with schools constructed using the traditional method. These comparisons are referred to as benchmarking and are based on the hard costs of building and equipping similar schools with certain adjustments to make figures comparable. The adjustments include:

- *Escalation adjustment* - to reflect the increase in the general level of construction prices from the date of tender to the date of preparation of the analysis.
- *Location adjustment* - to reflect the differences in labour and materials due to location. The purpose of this adjustment is to recognize that some locations are more costly because of higher construction labour rates and such factors as transportation costs for construction materials.

- *Site differential* - to reflect the differences in cost to make the land suitable for construction. This would reflect the difference in such costs as blasting and excavating.

**8.69** The benchmarking analysis also includes interim financing costs during the construction period for each alternative. The Hanscomb analysis was tabled in the House of Assembly on December 9, 1997.

**8.70** We did not verify the calculation of the adjustments made by Hanscomb. The location adjustment is subjective in that it is based on general cost differences applicable to certain locations rather than actual differences in costs incurred on specific school construction contracts. It is not susceptible to audit verification. We reviewed the site differential and escalation adjustments for reasonableness but did not audit these adjustments.

**8.71** Exhibits 8.2 and 8.3 include cost data for three P3 schools (Sydney, Porters Lake, and Horton) and six traditional schools. The traditional schools were chosen because they are representative of recently constructed schools.

**8.72** There are several points illustrated by Exhibit 8.3 including:

- Elementary schools generally require less space per student than schools with higher grades. This difference is due to the wider range of facilities required to deliver programs at higher levels.
- The cost estimates for P3 projects in progress are variable. For example, Horton was estimated to cost \$28.9 million in the construction agreement and the estimate was subsequently reduced to \$27.0 million. In December 1997, the estimated cost was reduced to \$25.5 million. Management of the Department of Education and Culture provided the following explanation for the most recent reduction in the estimate:

*“The construction contract for Horton includes ‘allowances’ for mechanical and electrical, technology, and furniture and equipment. We are managing these allowances so that quality is maintained but the mechanical and electrical is \$1 million less, technology is \$.5 million less, and furniture and equipment is \$.5 million less.”*

We cannot provide an actual cost for the school until construction is complete.

- Costs of school construction vary with the size of the school. Therefore, cost per square foot is one appropriate basis of comparison. The P3 schools generally have a lower square foot construction cost, although Auburn Drive High School (built under the traditional approach) had the lowest cost per square foot of any of the schools other than Horton (based on the December 1997 estimate for Horton).
- Space per student is another factor which influences comparative costs. The recently constructed junior high and high schools include more space per student than older schools. For example, Horton High School includes about 20% more space per student (based on planned capacity) than Auburn Drive High School.

Space per student may be calculated on the basis of planned capacity or actual enrollments. St. Andrew’s Junior High is an example of a situation where the basis chosen for calculating enrollments is significant. That school was planned to have

a capacity of 600 students from grades 6-9. The school board later decided to use it only for grades 7-9 with an actual enrollment of 539 for 1997-98. Exhibit 8.3 shows both planned and actual enrollments for each school.

**8.73** We cannot conclusively state that P3 schools are more or less costly than traditional schools due to the number of variables impacting the analysis. Any attempt to state that one school is more or less costly than another implies that there is a common basis for comparison when a single common basis does not exist. Exhibits 8.2 and 8.3 provide information sufficient to enable the reader to compare certain aspects of the costs of these schools but financing, operating and other costs to be incurred over the life of these schools are not included.

### CONCLUDING REMARKS

**8.74** Staff in the Departments of Education and Culture, Finance, and Economic Development and Tourism are very enthusiastic about the benefits of P3 arrangements for school construction. They believe that the process has been a catalyst for the creation of excellent learning environments. We visited the Sydney junior high school and found it to be unique and functional.

**8.75** In order to make significant decisions like the one to enter into P3 arrangements, government needs a clear understanding of costs and benefits including comprehensive risk analysis. Such an analysis is necessary to achieve good accountability and make the decision process transparent. This was not done for P3 schools, but should be done prior to making the decision to proceed with P3 arrangements in any other government sectors. The Department of Finance's November 1997 Discussion Paper *Transferring Risk in Public-Private Partnerships* is a good first step in analysing such risks.

**8.76** Monitoring and evaluating these arrangements both during and after implementation is also important and we encourage the government to establish an appropriate process to monitor and evaluate P3 schools which is independent of those with responsibility for the P3 initiative.

**8.77** The Priorities and Planning Secretariat recently released *Partnerships & School Construction: A Review* which makes several recommendations to improve government control over P3 school construction initiatives. Implementation of the recommendations of the Review will improve controls over certain aspects of the process but will not address all of our concerns. For example, the Review does not include a comprehensive analysis of the costs and benefits of leasing versus ownership of schools. The impact of operating leases on the long-term provision of education to students in the Province and the Province's current and future financial position and operating results is significant. Operating leases will result in the ownership of the schools resting with the private sector at the end of the lease term and the costs and benefits of such leases merit thorough consideration.

**8.78** Total costs to the Province of school buildings, in the form of final leases for P3 projects, should be known prior to starting construction. Implementation of the recommendations of the Priorities and Planning Secretariat's Review should ensure that this will occur for future projects.

**8.79** The eventual outcome of the P3 school construction process in terms of achievement of due regard for economy and efficiency cannot yet be determined due to the absence of signed leases. Memorandums of Agreement for two schools (Porters Lake and Hants East Middle) were approved by Executive Council in December 1997 and negotiations on final leases are proceeding. Until the final lease agreements and agreements covering other aspects of the schools including operations and technology refreshment are available, we cannot reach any firm conclusions on the value-for-money



implicit in P3 arrangements for school construction or whether the proposed accounting treatment is appropriate.

**8.80** We will be examining the leases and other agreements when signed and reporting the results of those audits in future Annual Reports.

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*Exhibit 8.1*

**STATUS OF P3 SCHOOLS**

School	Private Sector Partner	Date of Selection of Private Sector Partner	Formal Agreements in Place	Occupancy Date (planned or actual)	Approved Construction Cost
Sherwood Park Education Centre (Sydney junior high)	TR3LC	April 1995	Pre-development Agreement - Note 5	Jan. 1997	\$14.4 million
O'Connell Drive Elementary (Porters Lake Elementary)	Nova Learning Futures Inc.	Nov. 1995	MOA - Note 1 Construction Agreement Assignment	Sept. 1997	\$7.4 million
Horton High School	Hardman Lindsay School Ventures Inc.	Jan. 1997	Construction Agreement Assignment	Sept. 1998	\$25.5 million (Dec./97 Estimate)  \$27.0 million (pre-Dec./97 Estimate)  \$28.9 million (per Construction Agreement)
Meadowfields Elementary (Yarmouth)	TR3LC Nova	Aug. 1997	Pre-development Agreement - Note 3	Sept. 1998	\$8.0 million - Note 4
Hants East Middle	TR3LC Nova	Feb. 1997	MOA - Note 1 Construction Agreement - Note 2	Sept. 1998	\$17.3 million (per draft Construction Agreement)
Hants East Elementary	TR3LC Nova	Aug. 1997	Pre-development Agreement - Note 3	Sept. 1998	\$7.0 million - Note 4
Amherst Regional High	_____	_____	_____	Sept. 1999	_____
Aspotogan Elementary	_____	_____	_____	Sept. 1999	_____

Note 1 - Memorandums of Agreement between the Province and the consortiums set out general parameters for leases but do not include specifics regarding financing, operating and technology renewal.

Note 2 - This Agreement was unsigned as of the date of writing this Report (December 1997). Construction on the school began in October 1997.

Note 3 - These Agreements are signed by the proponent but not by the Department.

Note 4 - These are preliminary cost estimates prepared by the Department.

Note 5 - Certain of the terms and conditions of this Agreement were not implemented.

**COMPARATIVE SCHOOL CAPITAL CONSTRUCTION COSTS PER HANSCOMB REPORTS  
(EXCLUDING LAND COST)**

School	Construction					Technology	Government Costs	Soft Costs	Total Benchmark Costs
	Adjustments (not audited by Office of Auditor General)				Total				
	Hard Costs	Escalation	Location	Site					
<b>P3</b>									
Horton High									
- estimate Dec 2/97	\$18,500,000	\$ -	\$ -	\$ -	\$18,500,000	\$ 2,000,000	\$ 260,000	\$ 4,756,100	\$ 25,516,100
- pre-Dec. 2/97	19,500,000	-	-	-	19,500,000	2,000,000	260,000	5,256,100	27,016,100
Porters Lake Elementary	5,292,934	-	-	-	5,292,934	724,620	135,000	1,219,446	7,372,000
Sydney Junior High	10,121,495	-	-	-	10,121,495	1,525,000	250,000	2,543,847	14,440,342
<b>Conventional</b>									
Auburn Drive High	11,012,576	1,219,946	2,446,504	250,000	14,929,026	1,010,000	540,000	2,857,399	19,336,425
Basinview Elementary	6,373,091	714,117	-	333,580	7,420,788	945,300	420,770	1,163,432	9,950,290
Bible Hill Middle	8,000,296	-	1,200,000	111,000	9,311,296	810,600	440,000	1,703,484	12,265,380
Hebbsville Junior High	7,932,776	-	1,190,000	843,000	9,965,776	1,000,000	455,000	1,942,069	13,362,845
St. Andrew Junior High	10,333,000	252,163	1,048,315	575,000	12,208,478	1,029,813	465,000	1,934,600	15,637,891
<b>Design-Build</b>									
South Queens Elementary	5,370,368	131,767	-	272,550	5,774,685	784,000	497,000	1,051,800	8,107,485

*Exhibit 8.2*

**COMPARATIVE ANALYSIS OF SCHOOL CAPITAL CONSTRUCTION COSTS  
(EXCLUDING LAND COST)**

School	Square Footage	Enrollments		Total Benchmark Costs (from Exhibit 8.2)	Benchmark Cost per Square Foot	Benchmark Cost Per Student	
		Capacity	Actual			Capacity	Actual
<b>P3</b>							
Horton High							
- estimate Dec 2/97	171,000	1,050	- <sup>1</sup>	\$ 25,516,000	\$ 149.22	\$ 24,301	\$ - <sup>1</sup>
- pre-Dec. 2/97	171,000	1,050	-	27,016,000	157.99	25,730	-
Porters Lake Elementary	48,098	450	434	7,372,000	153.27	16,382	16,986
Sydney Junior High	88,013	650	704	14,440,342	164.07	22,216	20,512
<b>Conventional</b>							
Auburn Drive High	128,076	950	1,129	19,336,425	150.98	20,354	17,127
Basinview Elementary	63,200	600	635	9,950,290	157.44	16,584	15,670
Bible Hill Middle	71,747	600	564	12,265,380	170.95	20,442	21,747
Hebbville Junior High	81,000	450	472	13,362,845	164.97	29,695	28,311
St. Andrew Junior High	91,619	600	539	15,637,891	170.68	26,063	29,013
<b>Design-Build</b>							
South Queens Elementary	52,596	530	544	8,107,485	154.15	15,297	14,903

<sup>1</sup> School is scheduled for completion in September 1998.

