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DEPARTMENT OF TRANSPORTATION AND PUBLIC WORKS - HIGHWAY 104 WESTERN ALIGNMENT PROJECT

BACKGROUND

11.1 A number of years ago, the government identified the construction of a four-lane divided highway between Amherst and New Glasgow as a high priority. A portion of this stretch, from Amherst to Truro, represents Nova Scotia's highway link to the rest of Canada and the United States, and as such is heavily travelled by cars and trucks.

11.2 The distance between Amherst and New Glasgow is approximately 170 kilometres. The stretch was serviced by the Trans Canada Highway, which for most of the distance was only two lanes wide. Most of the Department's plans could be accomplished by twinning the existing highway. However, a section of this highway included a stretch through the Wentworth Valley, which has been the site of an above average number of automobile accidents. Several alternate routes were analysed and the Western Alignment was selected as the best option to bypass the Wentworth Valley.

11.3 After study and public consultation, the Department chose a 45 kilometre route linking Thomson Station to Masstown. The stretch was referred to as the Highway 104 Western Alignment. Although the completion of the bypass was a high priority, the Department had to work with decreasing financial resources as a result of government's fiscal reform program. Department officials realized that they required an innovative solution to complete the bypass project in a timely manner. It was decided to involve the private sector in the project, and to make the bypass partly self-funding. Part of the financial requirements would be met through borrowing by a non-government entity, which would be repaid by the collection of tolls on the public's use of the highway.

11.4 In the fall of 1994, the Province selected a consultant to study the feasibility of the Western Alignment project, and subsequently to help select a private sector partner to finance, design, build and operate the highway. In July 1995, by an Act of the Legislature, the Province incorporated the Highway 104 Western Alignment Corporation (HWAC) to provide for the financing, design, construction, operation and maintenance of the Western Alignment through a partnership of the public and private sectors. The Act declares the Corporation to be a non-government entity for all but certain specific purposes.

11.5 In June 1994 the Department issued a Request for Expression of Interest (REI) to design, finance, construct, operate and maintain the bypass, and seven responses were received. In January 1995 the Department issued a request for qualifications to the seven REI respondents and received four submissions. In July 1995 the Department issued a request for proposals to three qualified groups. Each group submitted a proposal and an in-depth process was used to evaluate them. In May 1996 the government, HWAC and the successful contractor concluded negotiations and entered into the contracts needed to establish a public-private partnership.

11.6 The Western Alignment toll road is expected to be completed by December 1997, which represents a 20-month construction period. The contracted cost of completing the road construction is \$112.9 million. The government estimated that it would have taken between three and eight years

using traditional Department construction and capital financing methods, and that it would likely have cost government more to complete the project.

11.7 The construction of the bypass is being funded by a \$27.5 million Federal government contribution, a \$27.5 million Provincial government contribution and \$66.4 million of long-term debt issued by HWAC. The debt financing for the project was arranged by a bond underwriter using a financial instrument called “accreting debt.” The accreting debt schedules the payment of principal and interest at a time and rate that corresponds to the collection of toll revenues. Accordingly, total debt will increase in the early years. There will be no toll revenues during the construction period and unpaid interest charges will compound and be added to the total debt. Furthermore, in the early years of the toll road’s operation, toll revenues will not be enough to cover the cost of servicing the debt, and a portion of interest will similarly compound. It is projected that toll revenues will increase over the years due to scheduled toll increases and forecasted higher traffic volumes, and at a future time the revenue will be sufficient to begin to pay both principal and interest, thus reducing the compounded debt. It is forecast that the total original debt of \$66.4 million will increase to approximately \$96.5 million in year 2006 before starting to decline.

RESULTS IN BRIEF

11.8 The following are the principal observations from this audit.

- The process used by the Department to select consultants and contractors for the project complied with government procurement objectives and followed principles of openness and fairness.
- We believe due regard was given to obtaining the lowest cost to construct the bypass. However, due to the nature of the public-private partnering process used, we could not assess whether negotiations subsequent to the selection of the private sector partner to establish the terms of the partnership resulted in the lowest possible cost and risk for the government.
- Accountability for the Western Alignment project could be improved. The accountability responsibilities of Highway 104 Western Alignment Corporation should be included in its incorporating Legislation.
- A summary of all costs of the project was not available from the Department as it has not been its nor government’s practice to accumulate all costs of a capital project in one place in the Province’s books of account.
- Based on our analysis, if the Province had borrowed the funds for the highway project directly, instead of Highway 104 Western Alignment Corporation, the debt service charges for the borrowing would have been significantly lower. However, if the Province borrowed the funds it would have assumed a greater amount of risk on the project, and we have been told by a representative of the company that designed and purchased HWAC’s bonds that additional debt on the Province’s books at this time could affect its credit rating and increase its average cost of borrowing. We cannot express an opinion on whether or not additional borrowing by the Province of this magnitude would change the Province’s average borrowing rate. The financial markets determine interest rates, and it is very difficult to forecast the activity and demands of the market.

- Financial projections for the project indicate that, over the 30-year term of the project, approximately \$151 million will be returned to the Province from the operation of the toll-road. However, we acknowledge that projections made for such a long period of time involve significant uncertainty and actual experience may differ. Also, there are provisions in the contracts to forego future toll increases, if agreeable to all parties to the contracts.

AUDIT SCOPE

11.9 In October 1996 we commenced a broad scope audit of the Highway 104 Western Alignment project in accordance with the provisions of the Auditor General Act. Our objectives were to:

- determine if the process used to select the project consultants and contractors gave due regard to economy and efficiency, and complied with government procurement objectives and policies; and
- assess the accountability structure and reporting established for the project.

11.10 The following general criteria were used in our audit.

- The process used to select the contractors and consultants, and the subsequent negotiations, should give due regard to economy and efficiency, and the process should comply with relevant government procurement objectives and policies.
- The principal accountabilities should be defined in Legislation and Regulations, and accountability reporting should be timely and address predefined project goals and performance measures.
- The Department should account to Executive Council and the Legislature for the planning and conduct of the project, as well as its experiences with the public-private partnering process.

PRINCIPAL FINDINGS

Selection of Contractors and Consultants

11.11 The final result of the Department's selection process was a partnership with a consortium of companies that will finance, design, build and operate the bypass. Various financial consultants, lawyers, engineers and other professionals were also required to facilitate the selection process and to help implement the project. As part of our audit, we examined the selection and hiring of all contractors and consultants for which significant sums were paid.

11.12 There are a number of policies and guidelines which were used by the Department to select contractors and consultants, including:

- the June 1992 Government Procurement Policy;
- the September 1992 Atlantic Procurement Agreement;
- the December 1993 Fairness in Government policy;

- the August 1994 Cooperative Business Solutions policy; and
- the July 1994 National Procurement Agreement.

11.13 The Western Alignment project was termed a public-private partnership, for which there are currently no specific policies, guidelines and procedures. (We comment further on the public-private partnership process in Chapter 3 of this Report.) Furthermore, HWAC is not considered by the government to be a crown corporation or an agent of the crown and, as such, was not required to follow government policies and guidelines. Yet, for the hiring of contractors and consultants we examined, there was compliance with most of the requirements embodied in the above-noted procurement policies and agreements. There were provisions in the request for qualifications and in subsequent proposals and discussions favouring Nova Scotia labour and subcontractors, which are not permitted by the Atlantic Procurement Agreement. However, the Atlantic Procurement Agreement does not identify HWAC as one of the entities to which the Agreement applies.

11.14 In public-private partnering, the private sector partner may be selected before a project is fully planned and all costs are determined. In such situations, the partner will assist in the planning and costing of the project. Government may select a partner using criteria such as a company's qualifications, experience, financial stability, willingness to assume a share of the project risk, and commitment to invest in the project. In the early stages of the project, as the planning and design component progresses, the costs and fees to be paid by and to each partner may be negotiated. Accordingly, when there is a lack of detailed consideration of costs and fees during the competitive stage of the selection process, it is difficult to review a public-private partnership project and assess whether fair value was achieved.

11.15 The Western Alignment project involved such a selection and negotiation process. However, we noted that the road construction cost was an outcome of competitive proposals, and we believe that due regard for economy was demonstrated for this, the major cost component of the project (\$112.9 million).

11.16 We cannot express an opinion upon whether the December 1995 to May 1996 negotiations with the chosen contractor resulted in the lowest possible cost and risk to the government. For example, there were several project requirements in the Department's request for proposals (and also reflected in the proposal submitted by the contractor), which were not met upon the completion of the negotiations.

11.17 Our original intent was to highlight in this section of the Report some of the outcomes of the negotiation process. However, most of these relate to information that the contractor considers confidential. The contractor is currently before the courts to argue that a document requested by other individuals under the Freedom of Information and Protection of Privacy Act should not be released. The items we wish to report are addressed by this document. However, there were two negotiated items in another document which is considered public, and we note them below.

- The request for proposals noted the Province would not guarantee the debt, but the final contracts included at least 13 specific covenants that, if breached, would require the Province to guarantee the debt (or alternately, the Province would have the option of repaying all outstanding debt plus a premium). Two examples include: “[if] the construction of the Project is terminated or abandoned by the Province or the Borrower prior to the completion of the Project” and “[if] the Design Build Contract is terminated for any reason and the Borrower does not within 90 days make arrangements to complete the construction of the Facility.”

- The request for proposals noted the Province would not guarantee the traffic volumes, but the final agreement required the Province to compel large trucks to use the road, to maintain a 30 kilometre per hour speed differential between the old and new road, and to agree to several obligations regarding traffic enforcement.

11.18 We do not suggest that these negotiated changes were inappropriate or represent inadequate regard for the costs and risks which the Province will bear. In fact, some negotiated changes favouring the contractor were counter-balanced with concessions by the contractor that improved the highway and/or lowered the Province's cost and risk. We are likewise restricted in discussing these items.

11.19 The purpose of this discussion is to illustrate how the negotiation process used to establish a public-private partnership can significantly affect project costs and outcomes, and how it can be very difficult for an auditor to assess whether the negotiation process resulted in the lowest possible cost and risk for government.

Accountability

11.20 There are three principle partners in the Western Alignment project: the government, HWAC and the contractor. We reviewed the accountability structure and reporting in place for the government (through the Department of Transportation and Public Works) and HWAC. In the section immediately below, we discuss the corporate structure of HWAC and its ramifications on accountability. The following three sections discuss accountability requirements and reporting relating to both the Department and HWAC.

11.21 *Corporate status* - In July 1995, HWAC was incorporated by an Act of the Legislature. The Act notes the purpose of the Corporation is “*to provide for the financing, design, construction, operation, and maintenance of the Western Alignment of Highway 104 (Trans Canada Highway) in the counties of Colchester and Cumberland by a partnership of the public and private sectors.*” The Act specifically notes that HWAC is not a crown corporation or an agent of the Province.

11.22 In several documents related to the project it was noted that a primary purpose of the Corporation was to insure the financing for the project is *non-recourse* to the Province (i.e., the government would not be responsible for any default on the debt). Accordingly, the Act declares that the Province is not liable for any debt of the Corporation. The Act also exempts the Corporation from various pieces of Provincial Legislation, including those relating to Provincial taxes and freedom of information and protection of privacy. However, the Act states “*the Corporation is an agency of government within the meaning of the Auditor General Act and that Act applies to the Corporation.*”

11.23 The Provincial Finance Act defines a crown corporation as one where the majority of board appointments are made by Governor in Council, as well as one where government owns at least 90% of the outstanding voting shares. In the case of HWAC, the government owns all of the outstanding shares and appoints each member of the Board of Directors. However, based on legal advice obtained by the Department, the definitive wording of the Act that created HWAC, and the fact that this Act was proclaimed subsequent to the Provincial Finance Act, gives it preeminence.

11.24 HWAC was set up to separate the project from the control and ownership of the government, and to separate government from certain financial and legal obligations. However, the Legislature created the Corporation, the Province owns and controls it, the purpose of the Corporation is to help build Provincial infrastructure that is funded by public money and owned by the Province, and there

are contract covenants that may, if breached, require the Province to guarantee the outstanding debt of the Corporation. It is our opinion that, *for accounting purposes*, HWAC is a government-owned corporation. Generally accepted principles for government accounting, adopted by the Federal and most provincial governments in Canada, require the inclusion of any government owned and/or controlled operation in the government's "reporting entity." Accordingly, the assets, liabilities and operations of HWAC should be included in the Government of Nova Scotia's reporting entity, and thus the Corporation should be fully accountable to the government and the Legislature.

11.25 Management disagrees with our view that the liabilities of HWAC should be included in the Government of Nova Scotia's reporting entity. Management does not see any reason for the government to account for liabilities that are non-recourse to the Province. In our view, the liabilities are non-recourse to the Province's consolidated fund. However, since the bond holders do have recourse to HWAC, and HWAC is owned and controlled by the Province, from the perspective of the Province's reporting entity (in accordance with generally accepted government accounting principles), the liabilities are those of the Province.

11.26 *Accountability requirements* - Whereas accountability requirements of government entities should be well defined and communicated, we recognize that there are alternative means of accomplishing this. Accountability requirements can be defined in legislation, Regulations, corporate charters and bylaws, and even in formal agreements. It is our Office's opinion, however, that the basic responsibility for a government entity's accountability to the House of Assembly should be included in legislation. In the case of HWAC, this would mean its July 1995 Act of incorporation. In the case of government departments, there are no significant legislated accountability requirements. Our Office, on several other occasions, has recommended the drafting and inclusion of such requirements in the *Provincial Finance Act*.

11.27 We noted the Act that created HWAC does not adequately define its accountability responsibilities. As a minimum, it would be appropriate for the legislation to have required:

- corporate accounts and records to be maintained;
- an annual financial statement;
- an annual audit;
- meetings of directors to be held;
- an annual meeting; and
- an annual report suitable for tabling in the House of Assembly.

11.28 We do not imply that such basic requirements do not exist. For example, we did note that a Corporation bylaw was created in May 1996 which indicated that meetings of directors *may* be called, shareholder meetings *may* be held, and directors *may* appoint auditors. (However, in most organizations there is a requirement to hold meetings and appoint auditors.) We also noted that the April 1996 Senior Bond Indenture requires the Corporation to maintain books and records in accordance with good accounting practices. Some of the Corporation's accountability and reporting requirements are also addressed in various other contracts and agreements to which the Corporation is a party. We suggest that such requirements be embodied in legislation so they can only be changed by a decision of the Legislature - the body to which the Corporation is ultimately accountable.

11.29 *Accountability reporting* - The Department provided us with reports it prepared on the planning and conduct of the Western Alignment project. For the most part, the documents were memorandums to the Executive Council and/or its Priorities and Planning Committee. They provided information on the project's background, financing, agreements, contingencies, as well as an evaluation of project objectives. However, we understand that, since May 9, 1996, no formal reporting has been made on the Western Alignment project, except for press releases.

11.30 We examined the documents provided and believe that some significant information was absent from the Department's reports, such as:

- a clear, concise financial summary or an indication of the expected total project cost, including all costs to be borne by the Department and Province;
- the costs of financing the debt, including the incremental interest rate and costs of private sector financing versus Provincial financing; and
- savings, if any, over the Department's cost to build the road with its usual methods.

11.31 We have been informed by management that much of this, as well as other information was conveyed to the Executive Council and its Priorities and Planning Committee verbally. Also, within the Department, there is a steering committee which is monitoring the project and the Department's Deputy Minister is a member. There is not yet any defined accountability reporting structure for the committee, but management informed us that it keeps the Minister well apprised. We cannot express an opinion on whether or not government decision-makers received all relevant information on the project because of the lack of formal documentation. We recommended that reporting in the future be more formal.

11.32 We believe that reporting to the Legislature, to date, has not been adequate as only limited information has been provided. Although questions have been asked in the House of Assembly about the project, and answers have been provided, there has been no formal reporting to the Legislature. Construction began in 1996, and at the time of our audit, a full year had not yet passed. We asked if the Department has included any of the planning details for the project in its annual report to the Legislature, but found that the last annual report tabled covers the year 1992-93, and its March 31, 1996 annual report has not yet been prepared. We asked whether the Department and HWAC will table reports in the future that discuss the project, and we were told that there is no definite date for reporting from either entity.

11.33 *Performance reporting* - We recommend that future reporting by the Department and HWAC be performance-based. That is, reports should define the objectives, requirements and assumptions established for the project, and indicate whether they are being achieved.

11.34 In the Department's July 1995 request for proposals to select a private sector partner, five objectives were outlined.

- To arrange for the private sector to carry out the project.
- To achieve the development of the facility at a reduced cost and in a shorter period than would be possible by traditional means.
- To minimize the Province's financial commitment to the project.
- To identify innovative financing and construction methods which may be applicable to other highway projects.
- To ensure that the highway, when its operation reverts to the Province after 30 years, is in a good state of repair and preservation, and is free and clear of encumbrances.

11.35 In addition, the project was undertaken after several studies and reports documented basic assumptions about toll road usage including traffic volumes and flows, potential transit time savings, fuel/energy savings, and accident statistics.

11.36 In the fall of 1996, the Department commenced a case study of the Western Alignment project. The study intends to assess the partnership selection and negotiation process, as well as the use of private sector advisers. The study will address and report upon areas of perceived success, problem areas that could be improved, and steps that could be eliminated.

11.37 We believe the case study is a valuable initiative and the insights gained should be shared with other government departments and agencies. At this time, the study will cover events only up to and including the conclusion of the negotiations in May 1996. We recommended that the Department consider also reviewing, at a later time, the period of construction in 1996 and 1997, and the project after a year or two of highway operation. Such assignments should examine the accuracy of the assumptions made to establish the project's viability, and should focus on the results of the project in comparison with the objectives noted above. Management indicated that it plans to conduct such reviews.

Other Observations

11.38 The objectives of our audit were to review the selection of the contractor and consultants used in the Western Alignment project, as well as to review the accountability structures and reporting employed for the project. The assignment required us to review an extensive number of documents and interview many individuals in order to understand the issues being examined. As a result, we made observations that are not related to our original audit objectives, and upon which we wish to report.

11.39 *Project costs* - The documents we reviewed noted the construction cost of the toll road as \$112.9 million. We did not see any document which provided an estimate of the total cost of the project, including all costs to the Province. We attempted to tabulate the full estimated cost of the project, as follows.

	(\$ millions)
Construction cost	\$ 112.9
Estimated sales and gas tax rebates	5.9
Upfront closing costs	2.4
Upfront post-closing costs	2.6
Land purchase and expropriation	2.9
Consultants and advisors	2.8
	\$ 129.5

11.40 The tabulation does not reflect salaries and benefits paid to staff of the Departments of Transportation and Public Works, Finance, Justice and others who dedicated considerable time and effort to the project. Discussions held with management indicated that, for the Department of Transportation and Public Works alone, up to 4.5 person-years of staff time were absorbed by the project. Also, because there may be costs relating to the project recorded in the accounts of other departments, we cannot be sure our tabulation is complete.

11.41 Based on discussions with Department officials, we understand that it is not their practice to accumulate and account for all highway construction costs in one report or place in the accounts of the Department. Based on our experience in other audits, it is also not normal accounting practice in other departments to account for all capital project costs together in this manner. In the past we have recommended, and we do so again, that the government develop a practice of accumulating and reporting all significant project costs so that government and the Legislature are aware of the total amount of public money spent on a project.

11.42 *Project financing* - The funding of the Western Alignment project is to be provided from the following sources.

	(\$ millions)
HWAC Debt Issues:	
Senior Bond Indenture - 30 years at 10.520%	\$ 51.0
Junior Bond Indenture - 15 years at 11.203%	9.9
Subordinated Note - 30 years at 16.864% (estimated)	5.5
Strategic Highway Improvement Program funding:	
Federal government's portion	27.5
Provincial government's portion	<u>27.5</u>
	<u>\$ 121.4</u>

11.43 One of the directions of government for the Western Alignment toll road project was to borrow a significant portion of the required funds without increasing the Province's total debt or other obligations (e.g., guarantees). To achieve this, the government created HWAC (and declared it not an agent of the crown), and had all debt financing for the project held by it.

11.44 As part of our audit, we examined the financing of the project to determine if due regard was given to economy. We compared the costs and benefits of financing the project in the manner selected, to the costs and benefits of financing the project in a more traditional method by way of public borrowing by the Province. Our analysis contrasts the two methods in terms of net effects over the 30-year term of the senior bonds

11.45 An October 1995 consultant's report prepared for the Department noted that, after reviewing various financing proposals, unrated or low-rate investment-grade senior debt placed privately (i.e., outside of government) may have an interest rate premium of 1.75% to 2.0% over long-term Canada (i.e., government) bonds. Subordinated debt may have a 4.75% interest rate premium. We understand that the Province of Ontario opted to fund a toll road project through the government as the interest rate premium for private financing was estimated to be about 1.5%.

11.46 The preceding funding summary indicates the effective annual yield of the various project debt issues. We have prepared the following estimate of interest rate differentials for the Western Alignment project.

	Senior Bonds \$51.0 million BBB(high)	Junior Bonds \$9.9 million (unrated)	Subordinate Notes \$5.5 million (unrated)
Government of Canada Bonds - June 1, 2025 - as of April 3, 1996	8.101%		8.101%
Government of Canada Bonds- June 1, 2010 - as of April 3, 1996		7.904%	
Add premium for Province of Nova Scotia's lower credit rating	<u>.400%</u>	<u>.400%</u>	<u>.400%</u>
Estimated rate if Province had issued the debt	8.501%	8.304%	8.501%
Effective annual yield of debt issues by HWAC	<u>10.520%</u>	<u>11.203%</u>	<u>16.864%</u>
Excess of HWAC rates over estimated rates available to the Government of Nova Scotia	<u>2.019%</u>	<u>2.899%</u>	<u>8.363%</u>

11.47 We applied the excess rates to the scheduled repayment of debt and calculated that the extra interest paid over the term of the project, estimated on a net present value basis, may be in the range of \$20 million to \$25 million.

11.48 A representative of the company that designed and purchased the bonds of HWAC indicated to us that financing the project through an issue of public debt by the Province would have affected the Province's credit rating and could have increased the cost of the Province's borrowing on all of its debt. It was suggested that the lower credit rating could add .05% to the Province's average borrowing rate. However, the financial effect of such an increase in the average rate of borrowing is very difficult to quantify. The incremental increase in interest rates would only apply to new issues of debt by the Province, and to refinancing of debt as it matures. Depending on the extent of new issues and the timing of maturities, the additional cost to the Province could be significant.

11.49 We cannot express an opinion on whether or not additional Provincial borrowing of \$96.5 million would have triggered an increase in the Province's average borrowing rate. The highest level to which the project debt would accrete (\$96.5 million) is very small in terms of total Provincial unmatured debt of \$8.2 billion. Also, in the case of the toll road project in Ontario, it was believed there would be no impact on the Provincial credit rating and debt service costs because the rating agencies would make allowances for the self-financing aspects of a toll road project. However, management reminded us that the bond rating agencies are very sensitive about the Province's debt levels, and any incremental increase in the Province's debt could be the transaction that triggers a change in its credit rating.

11.50 Other benefits were attributed to the financing arrangements made for the Western Alignment project. The accreting nature of the debt made it possible to match debt servicing costs to revenues from the toll road. If the Province had borrowed the debt through a traditional public offering, the consolidated fund of the Province would have had to subsidize toll rates in the earlier years of the operation of the road in order to meet the objective of having tolls begin at \$3 per car and \$2 per axle of larger trucks, and to have the tolls increase no faster than the rate of inflation in the Province.

11.51 Also, the financing arrangement selected transferred certain risks from the Province to the bond holders. If the Province had issued debt, it would have borne more risk with regard to the revenue performance of the toll road.

11.52 *Toll revenues* - The Department's financial consultants prepared a Project Transaction Summary for the project in June 1996. The summary includes a projection of sources and uses of cash over the 30-year term of the project. The projection anticipates that approximately 52% of toll revenue will be derived from larger trucks which are compelled to use the road and 48% of tolls will come from cars and small trucks. The projection also estimates that, of the \$576 million of revenues received over the 30 years, potentially \$151 million could be returned to the Province.

11.53 Based on discussions with Department officials, the \$151 million would be available to the Province only if actual toll road operations occur exactly as forecasted, and then the cash would be available only in the latter half of the term. The projection estimates revenues and costs over a 30-year period, and such future-oriented analysis is subject to considerable uncertainty. Further, if excess cash becomes available there are provisions in the contracts to forego future toll increases, if agreeable to all parties to the contracts.

11.54 *Provincial commitments and obligations* - On May 22, 1996, HWAC entered into at least 22 agreements, indentures and contracts to implement the Western Alignment project. The closing agenda on that day listed 82 items or documents related to the closing. Subsequent to the closing, the Corporation's lawyers prepared a substantial list of the Corporation's obligations resulting from the agreements and contracts.

11.55 The closing also gave rise to a number of commitments and obligations for the Province. We understand there is no similar comprehensive list of Provincial obligations, but noted that several documents contain significant matters which should be monitored. We recommended that all Provincial commitments and obligations be summarized so responsibility to monitor and control the obligations can be delegated.

11.56 *Highway 104 Western Alignment Corporation* - The Corporation was created in July 1995 by an Act of the Legislature. The Act requires that all members of the Board of Directors be appointed by the Governor in Council. To date, only one person has been appointed to the Board. The Corporation has no employees, but does use the services of contract staff and staff of the Department of Transportation and Public Works.

11.57 As of January 1997, there were no accounting-related books or other records available for HWAC. Highway construction costs are paid and reported to HWAC by the construction trustee contracted by the Corporation. However, there are no books of account at HWAC that record these costs, other corporate costs, or its assets and liabilities. We understand that a consultant will be hired to record the accounting transactions in time for the audit of HWAC's March 31, 1997 financial statements.

11.58 We recommended that the accounts of HWAC be recorded and financial statements be prepared on a regular, timely basis. Such records and reports are important to management's control and decision making with respect to the Western Alignment project.

CONCLUDING REMARKS

11.59 The Highway 104 Western Alignment project represents one of the government's first major experiences with public-private partnering. We have observed that there are advantages in the use of this approach, including the sharing of project risk, the leveraging of private-sector expertise, and the mobilization of greater amounts of physical and financial resources towards a project.

11.60 Based on our audit, we have three observations we wish to highlight for consideration with respect to future use of public-private partnering. First, it is very difficult to determine whether, once a private partner is selected, negotiation of contract terms and conditions has minimized the government's cost and risk on a project. The Western Alignment project established the construction cost of the highway as part of the selection of the partner, and accordingly later negotiations involved costs and risks that were of lesser significance. We wish to warn that other public-private partnerships may leave the determination of a more substantial portion of project costs and risks to the negotiation stages, thus making it even more difficult for management and auditors to determine if the lowest cost and risk was obtained for the Province.

11.61 Our second observation relates to project financing. It appears to be generally accepted that financing a project through an entity other than the government increases the cost of borrowing for the project. However, there may be other costs involved if the Province were to borrow to fund a project, including the financial effect of a change in its average borrowing rate. It is important that the costs and benefits of alternative borrowing arrangements be explicitly factored into all future government decisions about the costs and benefits of public-private partnerships.

11.62 Our third observation relates to accountability. It is our view that partnerships between the government and private sector that involve significant amounts of public funds be accountable to the House of Assembly. This is fundamental to stewardship over public funds, and represents a significant responsibility of elected members of the House to the public they represent. Accordingly, we believe future public-private partnerships should be structured to preserve such accountability.

DEPARTMENT'S RESPONSE

Attached please find the response of the Department of Transportation and Public Works to the Report of the Auditor General on the Highway 104 Western Alignment project.

Thank you for the time and consideration of you and your staff in assessing this unique public-private partnership. Your perspective in auditing all facets of government business is a valuable part of our democratic process.

Be assured my Department will always facilitate your efforts to ensure all the facts are available for your consideration.

The Department of Transportation and Public Works acknowledges that the Office of the Auditor General has produced a fair analysis of the Highway 104 Western Alignment public-private partnership.

We are pleased the Auditor General recognizes that the process used by the Department to select consultants and contractors for the project complied with government procurement objectives and followed principles of openness and fairness. The Auditor General also agrees that due regard was given to obtaining the lowest cost to construct the highway.

With this prototype public-private partnership, Nova Scotia holds a leading position on the North American stage in leveraging the combined resources of the public and private sectors to develop essential infrastructure in times of fiscal restraint.

The Highway 104 Western Alignment is built on the foundation of sound fiscal policy that draws the line on government borrowing. Adding to the provincial debt was not an option for this project.

Thanks to the creative leadership of the public sector, and the innovation and efficiency of private sector partners, Nova Scotians are getting a safer, faster highway to move people and goods through the heartland of Atlantic Canada.

In a public-private partnership, sophisticated negotiations determine how the costs, risks, and rewards of a project are shared. In the Highway 104 negotiation, the private partner has assumed significant risk, including cost overruns on construction as a result of factors such as design flaws or interruptions due to weather.

The private investors in this project have taken the full risk for traffic volume and thus for revenue flow from the tolls. If there is a shortfall in revenue, the government is not liable for the difference. This was key to making the deal viable for the Province of Nova Scotia. As the Auditor General acknowledges, the liabilities of the Highway 104 Western Alignment Corporation are, in fact, non-recourse to the Province's consolidated fund.

Understandably, through the negotiating process, the private sector partners have asked for and received certain undertakings by the Province to ensure a viable toll operation. These covenants do not provide direct financial guarantees on the debt, and all are within the Province's control.

The result for Nova Scotians is a safer highway, built faster with minimal government financial contribution or risk, while honouring the Government's responsibility to ease the burden of Nova Scotia's staggering debt.

This project has been lauded nationally and internationally for its innovative financing and risk-sharing design. The House of Commons Standing Committee on Transport says Highway 104 is the best example of how a public-private partnership should work. This project has been praised in three international trade magazines: Privatization International Infrastructure Yearbook; Infrastructure Finance; and Project and Trade Finance.

The Government of Nova Scotia stands behind public-private partnerships as a way of providing costly infrastructure for its citizens. The Auditor General reiterates the advantages of this approach, including "the sharing of project risk, the leveraging of private-sector expertise, and mobilization of greater amounts of physical and financial resources towards a project."

The Government is confident that all facets of this public-private partnership are sound, supportable and conceived in the best interests of Nova Scotia.
