The National Audit Office’s role in Complex Infrastructure Procurement

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The NAO’s aim:

- To apply the **unique perspective of public audit** to support **lasting improvement in public services**

- Unique perspective of public audit
  - Value for money
  - Wide definition of ‘resources’
  - Across government perspective
  - Main intermediary between users and decision-makers

- Lasting improvement in public services
  - Focus on quality of decision-making and ongoing management
  - Enhance capability of Government Departments
  - Advocate information-led management
  - Transfer knowledge and support continuous learning
The NAO’s values

• Independent
• Authoritative
• Fair
• Collaborative
There is a range of infrastructure delivery models

Infrastructure is the basic physical and organisational structure needed for the operation of a society or enterprise; or the services and facilities necessary for a society to function.

Summary of delivery models for infrastructure

- **Financing**
  - Private
    - Provision by public body or publicly owned body
  - Public
    - Taxpayers
    - Consumers

- **Control and influence mechanisms**
  - Contract/franchise
  - Price Regulation
  - Other Market Intervention
Value for Money risks and challenges can be simply characterised

Choosing the right delivery model

Getting projects financed

Ensuring efficient delivery
# Examples of previous NAO Work

<table>
<thead>
<tr>
<th>Treasury &amp; Cabinet Office</th>
<th>Departments</th>
<th>Regulators</th>
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</table>
| • Lessons from PFI and other projects | • Preparation for the roll out of smart meters (DECC)  
• Financing PFI projects in the credit crisis and the Treasury’s response  
• Managing complex capital investment projects using private finance  
• Private Finance Projects  
• Performance of PFI Construction | • Ofwat: meeting the demand for water  
• Performance of Ofgem  
• Office of Rail Regulator: regulating the performance of Network Rail |
CASE STUDY – HS1
High Speed 1

- HS1 is the UK’s first High Speed Line
- It connects the Channel Tunnel with Central London
- It involved construction of a new line, and new station facilities in central London (Kings Cross St Pancras) and intermediate stations
- The ‘intermediate stations’ include Stratford, the key hub for the Olympics
- It sought transport benefits – through journey time savings
- It sought regeneration benefits in London and at the intermediate stations
- It was a complex infrastructure procurement along PFI/PPP lines
- As well as economic drivers, it had a significant strategic value for successive Governments
Case Study – HS1 – The NAO’s Role

- The NAO has produced three reports
  - 2001 – The Channel Tunnel Rail Link
  - 2005 – Progress on the Channel Tunnel Rail Link
  - 2012 – The completion and sale of High Speed 1 (published on Wednesday – so there are limitations on what I can say today)

- Four main themes:
  - Structuring/restructuring
  - Risk transfer
  - Economic justification
  - Departmental capability
NAO findings– Financing:

• 1996: Original vision - a **privately financed** PPP project with capped Government contribution
• 1998: This model collapsed in 1998 and **project restructured**
  • Still in private ownership, but with Government guaranteeing project funds to finance construction (including contingency headroom)
  • Reduced cost of capital
  • In 1998, Government did not expect to pay out on guarantees
• 2002: Further **restructuring**
• 2006: Protections and guarantees resulted in project being reclassified to the public sector in 2006
• 2009: Government **renationalised and restructured** the project, taking over the guaranteed debt
• 2010: **Concession sold** to private sector consortium
Case Study – HS1 - what went wrong?

Forecast and actual international passenger numbers

Source: NAO analysis

Original bidder forecast assumed a fully loaded 800 seat train leaving London every 12 minutes
NAO findings – Risk Transfer

Construction cost risk - **TRANSFERRED**
• High Speed Line constructed above target costs, but within contingency
• Target pricing arrangements may have helped deliver this result, with some renegotiation with Government

Operational risk - **TRANSFERRED**
• Operational risk transferred to private sector

Revenue risk - **SHARED**
• Taxpayer still indirectly underpins 60% over infrastructure charges

Financing risk - **SHARED**
• Taxpayer has assumed Government guaranteed debt of £4,839 million (2010 NPV)
## Case Study – HS1 – Business Case

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<tbody>
<tr>
<td>Benefits excluding regeneration benefits</td>
<td>2,270</td>
<td>To be confirmed in NAO report published on 29 March</td>
</tr>
<tr>
<td>Regeneration benefits</td>
<td>500</td>
<td>Tbc</td>
</tr>
<tr>
<td>Total benefits (with regeneration benefits)</td>
<td>2,770</td>
<td>Tbc</td>
</tr>
<tr>
<td>Costs</td>
<td>(2,050)</td>
<td>Tbc</td>
</tr>
<tr>
<td>BCR without regeneration benefits</td>
<td>1.1</td>
<td>Tbc</td>
</tr>
<tr>
<td>BCR with regeneration benefits</td>
<td>1.5</td>
<td>Tbc</td>
</tr>
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NAO findings—Economic justification

- Independent assessment of Benefit Cost Ratio
  - 2001 report recalculated the Benefit Cost Ratio used by the Government in 1998 to justify HS1
  - The Government’s economic justification had been calculated at £1,010 million (1997 prices, including regeneration benefits), with a BCR of 1.5:1
  - The study found errors in the Government’s figures and use of some unconventional methodologies
  - The economic justification was recalculated by the NAO to £220 million (1997 prices, excluding regeneration benefits), with a BCR of 1.1:1
- 2001, 2005 and 2012 reports all sought clarity on the regeneration benefits sought for the project
NAO findings – Departmental capabilities

- All three reports comment positively on Department for Transport’s:
  - options appraisal
  - negotiation approach
  - financial market execution
- 2005 report also noted the need to retain specialist project knowledge within the Department
- The Department has established its own in-house corporate finance team
MORE GENERAL LESSONS
The role of the NAO in complex infrastructure procurement

- The NAO has also sought to adapt our work on infrastructure to changing circumstances:
  - Phase 1 – 1990s to c.2006 – assessing the delivery of individual PFI contracts, largely social infrastructure
  - Phase 2 – 2006-2011 – systemic PFI issues in contracting, contract management and (especially) financing, both debt and equity
  - Current phase – bringing together NAO work on economic infrastructure: contracting, regulation, project initiation
The role of the NAO in complex infrastructure procurement

- The NAO’s work on HS1 reflects the NAO’s core values:
  
  - **Independent**: honest assessments of value for money; scepticism on risk transfer
  - **Authoritative**: build up of concentrated expertise within specialised NAO teams
  - **Fair**: the balance between supporting well thought through risk taking and challenge; and understanding context of decision-making
  - **Collaborative**: the quality of audit work lies not just in the core findings, but also in whether recommendations have a meaningful influence on decision-making processes and Departmental capabilities
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