The Five Inherent Risk Factors

Explaining Why Projects "Fail"

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About the Author

Paul Emanuelli is the General Counsel and Managing Director of the Procurement Office. He was recognized by *Who's Who Legal* as one of the top ten public procurement lawyers in the world. His portfolio includes advising on strategic governance in public purchasing and on negotiating high-profile major procurement projects. Paul has an extensive track record of public speaking, publishing and training. He is the author of *Government Procurement, The Laws of Precision Drafting*, *Accelerating the Tendering Cycle* and the *Procurement Law Update* newsletter. Paul hosts a monthly webinar series and has trained and presented to thousands of procurement professionals from hundreds of institutions across North America through the Procurement Office and in collaboration with leading industry organizations including NIGP, SCMA, the University of the West Indies and Osgoode Hall Law School.

The Five Inherent Risk Factors

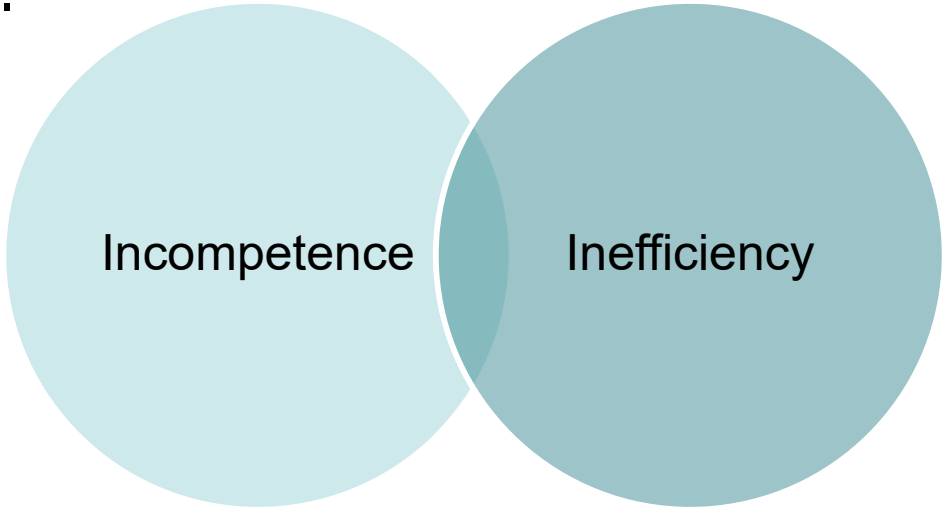
Overview

This discussion introduces the five inherent risk factors that impact major public sector procurement projects, and explains how these factors contribute to overly optimistic planning assumptions and impose unrealistic expectations on major project teams.

The Five Inherent Risk Factors

The Flawed Execution Fallacy

The Flawed Execution Fallacy assumes that public sector project failures can be blamed on project-level incompetence and inefficient institutional-level project management mechanisms.

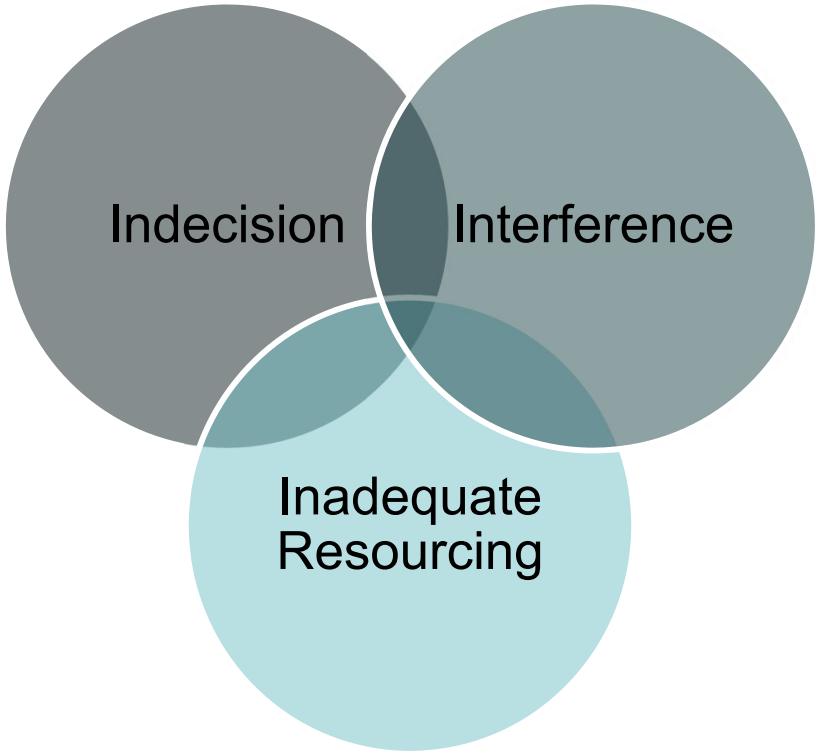


While partially true, this accounts for only 40% of the inherent risk factors that plague public sector procurement projects.

The Five Inherent Risk Factors

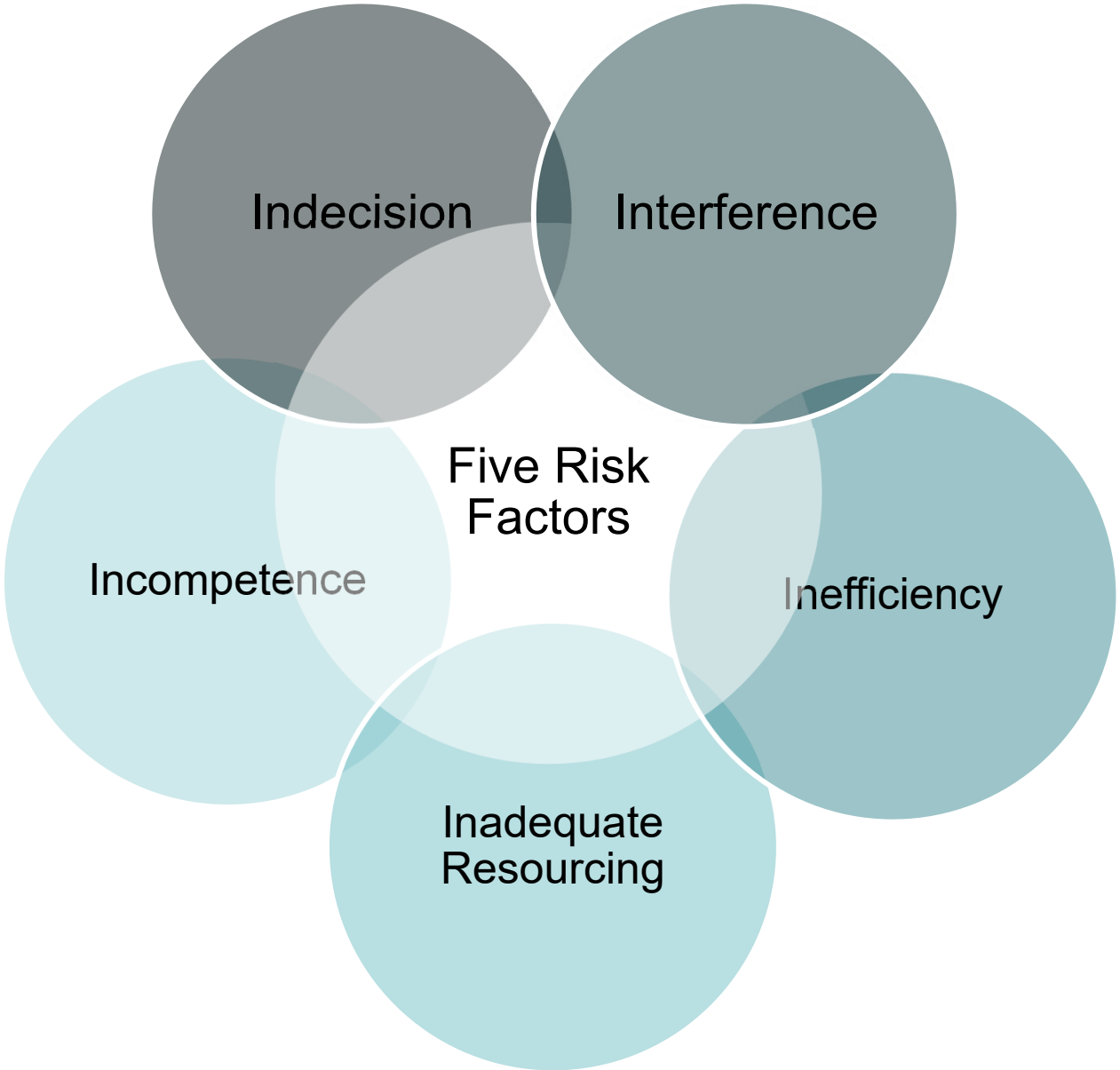
Systemic Structural Failings

Systemic Structural Flaws caused by senior-level indecision, interference, and inadequate resourcing complete **The Five Inherent Risk Factors** that undermine major public sector procurement projects.



The Five Inherent Risk Factors

The Full Picture



Ontario Pays $8 Billion "Extra" for P3s

Auditor General of Ontario, 2014

By way of example, in its 2014 annual report findings entitled *Infrastructure Ontario – Alternative Financing and Procurement*, the Auditor General of Ontario determined that the government's use of the private sector to finance and deliver major infrastructure projects through public-private partnerships (P3s), referred to in the report as Alternative Financing and Procurement or AFP, cost the taxpayer an additional $8 billion in project costs when compared to more conventional government-run procurement projects:

Ontario Pays $8 Billion “Extra” for P3s

Auditor General of Ontario, 2014

When the province constructs public-sector facilities such as hospitals, courthouses and schools, it can either manage and fund the construction itself or have the private sector finance and deliver the facilities. For 74 infrastructure projects (either completed or under way) where Infrastructure Ontario concluded that private-sector project delivery (under the Alternative Financing and Procurement [AFP] approach) would be more cost effective, we noted that the tangible costs (such as construction, financing, legal services, engineering services and project management services) were estimated to be nearly $8 billion higher than they were estimated to be if the projects were contracted out and managed by the public sector.

Ontario Pays $8 Billion “Extra” for P3s

Auditor General of Ontario, 2014

However, the report stated that according to Infrastructure Ontario, these additional P3/AFP costs were offset by avoiding the additional cost overruns and delays that would have occurred had the public sector directly managed those same projects:

Ontario Pays $8 Billion “Extra” for P3s

Auditor General of Ontario, 2014

However, this $8-billion difference was more than offset by Infrastructure Ontario’s estimate of the cost of the risks associated with the public sector directly contracting out and managing the construction and, in some cases, the maintenance of these 74 facilities. In essence, Infrastructure Ontario estimated that the risk of having the projects not being delivered on time and on budget were about five times higher if the public sector directly managed these projects versus having the private sector manage the projects. It valued the cost of the risks under public sector delivery to be $18.6 billion and the risks under AFP delivery to be $4 billion.

Ontario Pays $8 Billion “Extra” for P3s

Auditor General of Ontario, 2014

While the Auditor General acknowledged that the projects in question were delivered “on time and on budget”, it ultimately concluded that the tangible project costs were $8 billion higher in direct financial impact to the province when compared to the estimated costs of directly managing those projects:

Ontario Pays $8 Billion “Extra” for P3s

Auditor General of Ontario, 2014

While projects managed by the private sector for the most part were delivered on time and cost about the same as their contracts specified, according to Infrastructure Ontario’s estimates, the tangible costs are still almost $8 billion higher than if the public sector had been able to contract out the projects to the private sector and oversee their successful delivery. Successful delivery means on time and on budget, and ensuring that the infrastructure is properly maintained over its useful life. Infrastructure Ontario believes that private-sector financing contributes to the successful delivery of complex projects under the AFP approach, but should only be used to the extent that is required to transfer risks.

Ontario Pays $8 Billion “Extra” for P3s

Auditor General of Ontario, 2014

The private sector initially finances construction of AFP projects, but, as with projects delivered by the public sector, the province ultimately pays for these projects under the terms of their contracts, some of which are up to 30 years. The March 31, 2014 Public Accounts reported almost $23.5 billion in liabilities and commitments relating to AFP projects that the present and future governments, and ultimately taxpayers, will have to pay. However, the financial impact of AFP projects is higher since the province has also borrowed funds to make the payments to AFP contractors when the various projects reached substantial completion. These borrowed amounts, which we estimate to be an additional $5 billion, are part of the total public debt recorded in the March 31, 2014, Public Accounts.

Ontario Pays $8 Billion “Extra” for P3s

Auditor General of Ontario, 2014

As this audit report illustrated, the retroactive assessment of project success will be based, at least in part, on whether a project came within its original cost estimates. However, when those original estimates are based on questionable calculations and assumptions, the entire benchmarking exercise can be called into question.

Ontario Pays $8 Billion “Extra” for P3s

Auditor General of Ontario, 2014

The Auditor General’s after-the-fact cost assessments in this report were a highly speculative apples-to-oranges contrast between the lower estimated costs for government-run projects (which are debatable since government cost-and-time estimates for conventionally run projects are notoriously unreliable), and the actual costs of the P3/AFP approach.

Ontario Pays $8 Billion “Extra” for P3s

Auditor General of Ontario, 2014

While the actual costs for the P3 approach may have been higher than the estimated costs of conventionally run projects, additional P3 costs are rationalized by Infrastructure Ontario through another speculative and highly questionable assessment.

Ontario Pays $8 Billion "Extra" for P3s

Auditor General of Ontario, 2014

This evaluative process purportedly examined the actual costs for the conventional approach when factoring in risk costs for government-led projects as five times the risk of P3 projects (e.g. $18 billion risks for conventional approach vs. $4 billion with the P3/AFP approach). In other words, the findings that the P3 projects were "on budget" relied on, at least in part, "cost savings" calculations based on the assumption that government-led projects have a project failure risk that is five times higher than initial project estimates.

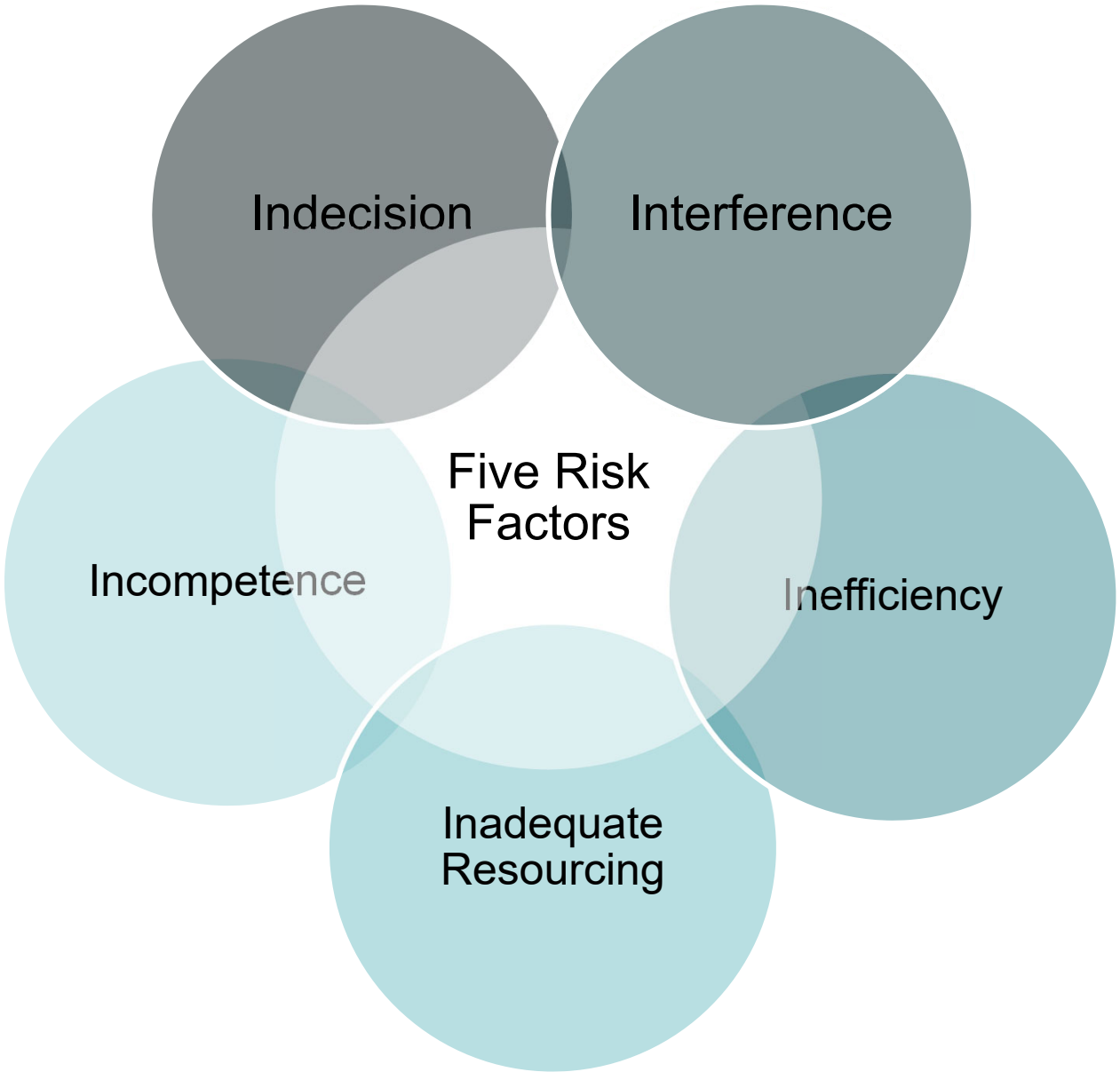
Ontario Pays $8 Billion "Extra" for P3s

Auditor General of Ontario, 2014

As this report illustrated, governments that use the P3/AFP approach tend to pay a high-risk premium to protect the taxpayer from government ineptitude. Even so, while P3 projects presumably save money by shielding the taxpayer from government mismanagement, the question yet remains: How much cost savings could be realized if government institutions simply ran their own projects competently, based on realistic cost and time estimates?

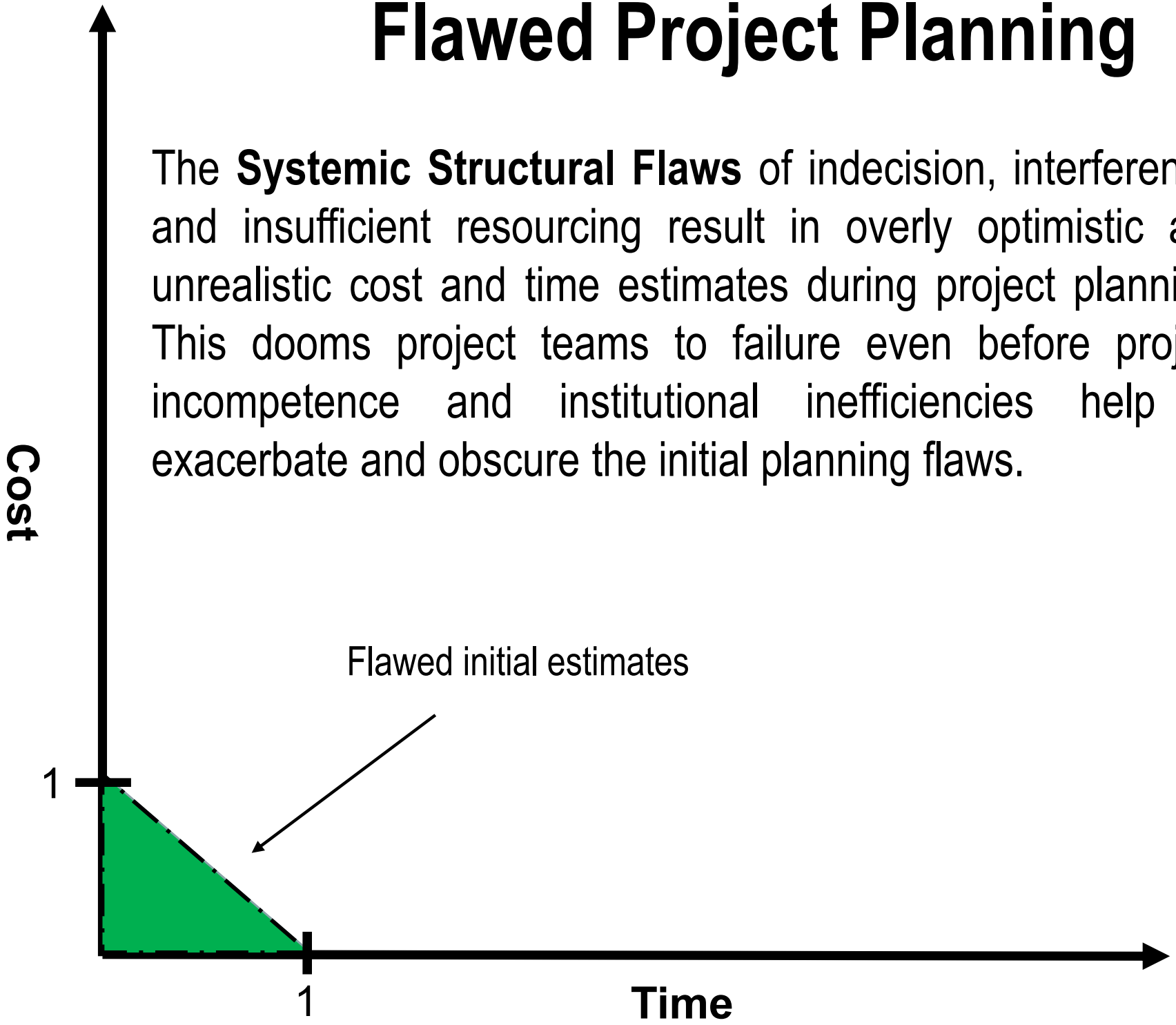
The Five Inherent Risk Factors

The Full Picture



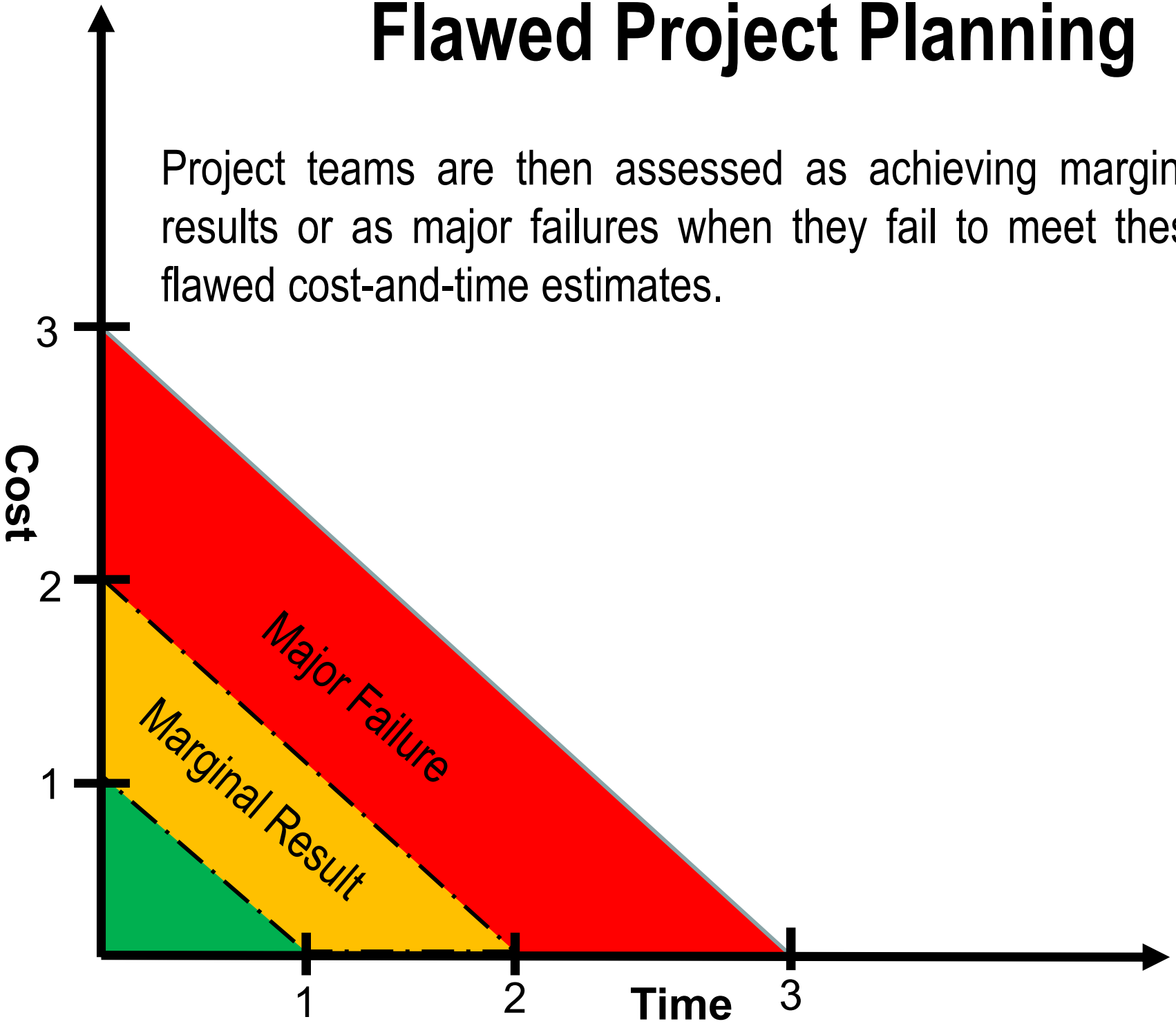
Flawed Project Planning

The **Systemic Structural Flaws** of indecision, interference, and insufficient resourcing result in overly optimistic and unrealistic cost and time estimates during project planning. This dooms project teams to failure even before project incompetence and institutional inefficiencies help to exacerbate and obscure the initial planning flaws.



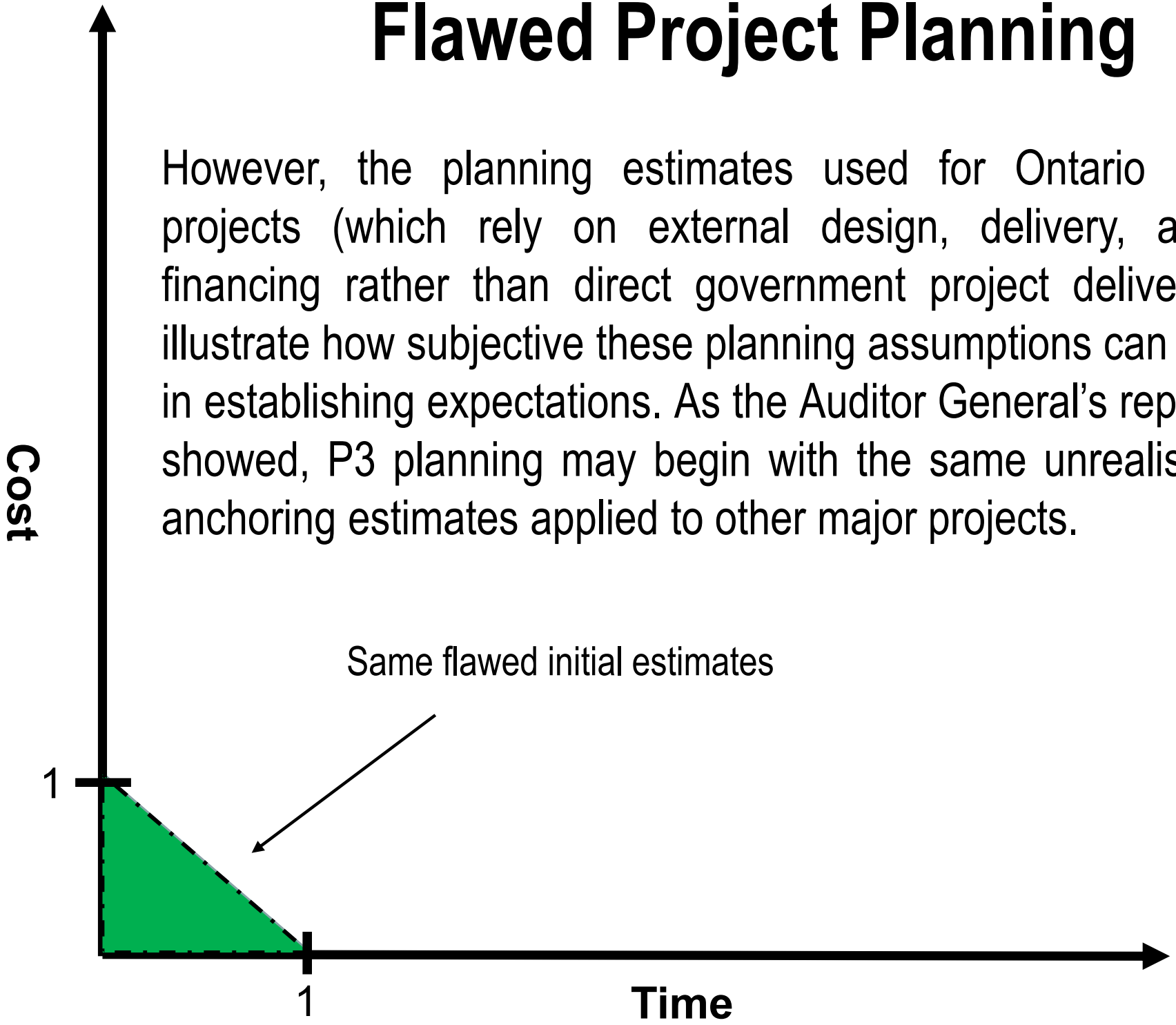
Flawed Project Planning

Project teams are then assessed as achieving marginal results or as major failures when they fail to meet these flawed cost-and-time estimates.



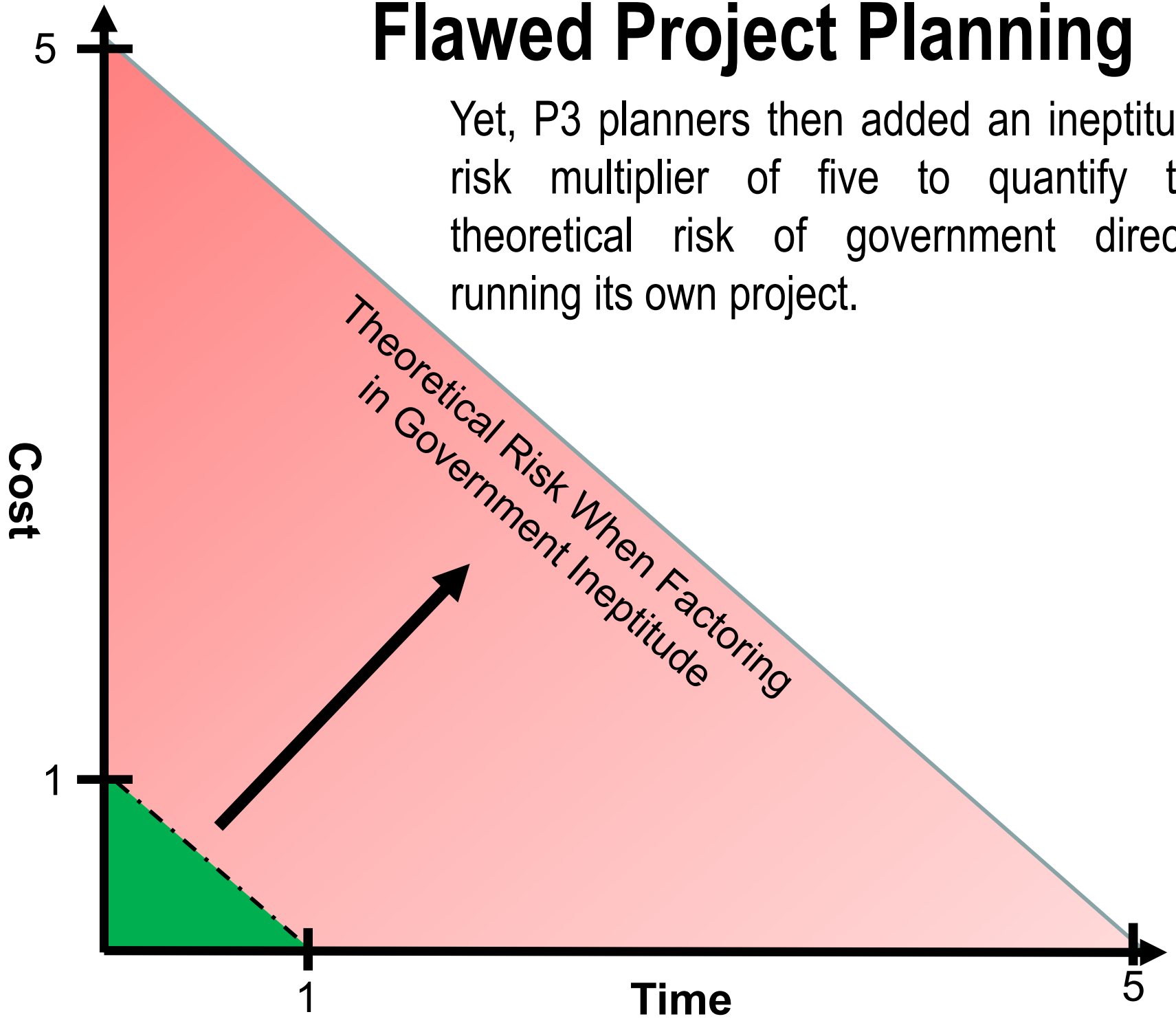
Flawed Project Planning

However, the planning estimates used for Ontario P3 projects (which rely on external design, delivery, and financing rather than direct government project delivery) illustrate how subjective these planning assumptions can be in establishing expectations. As the Auditor General's report showed, P3 planning may begin with the same unrealistic anchoring estimates applied to other major projects.



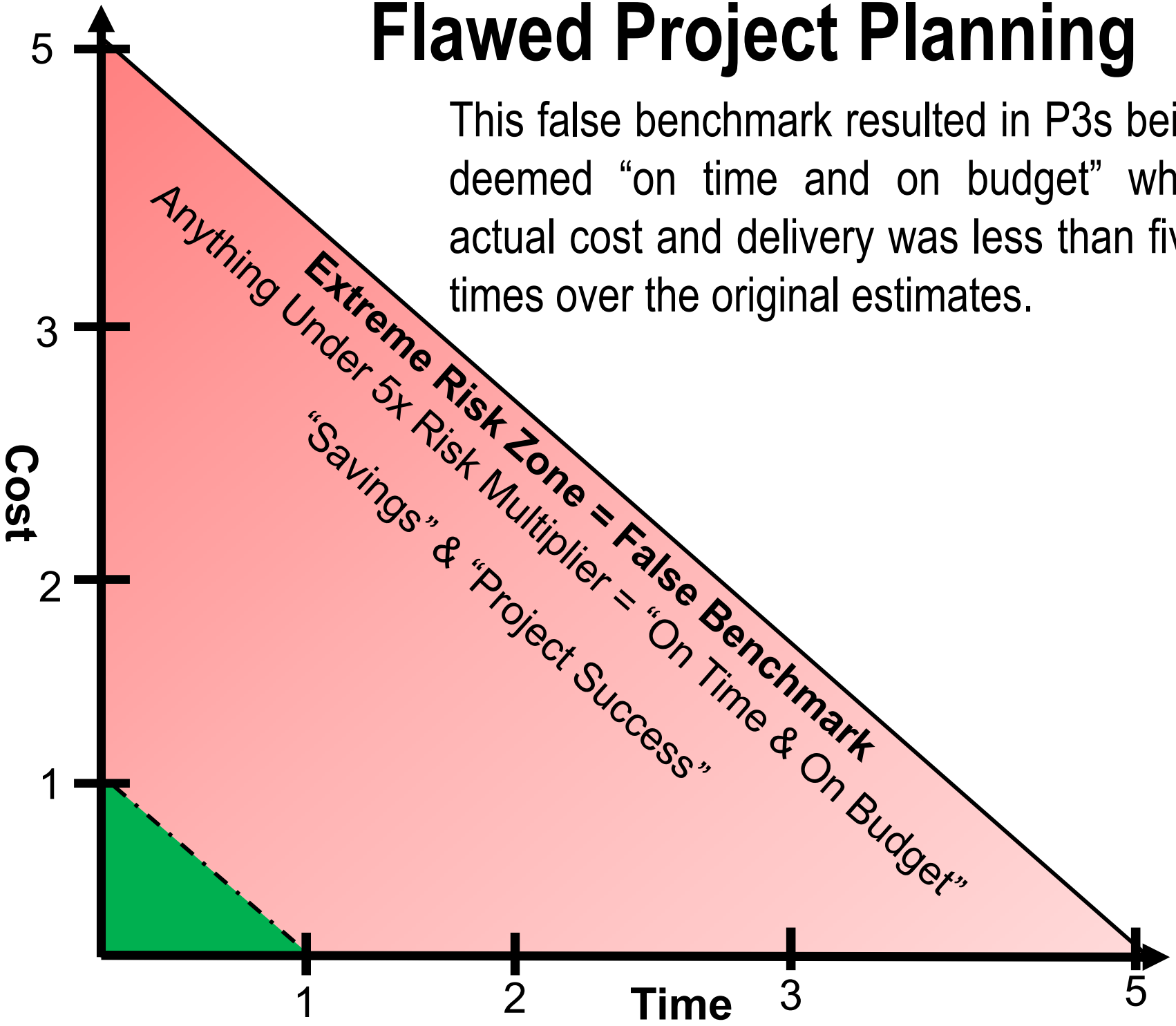
Flawed Project Planning

Yet, P3 planners then added an ineptitude risk multiplier of five to quantify the theoretical risk of government directly running its own project.



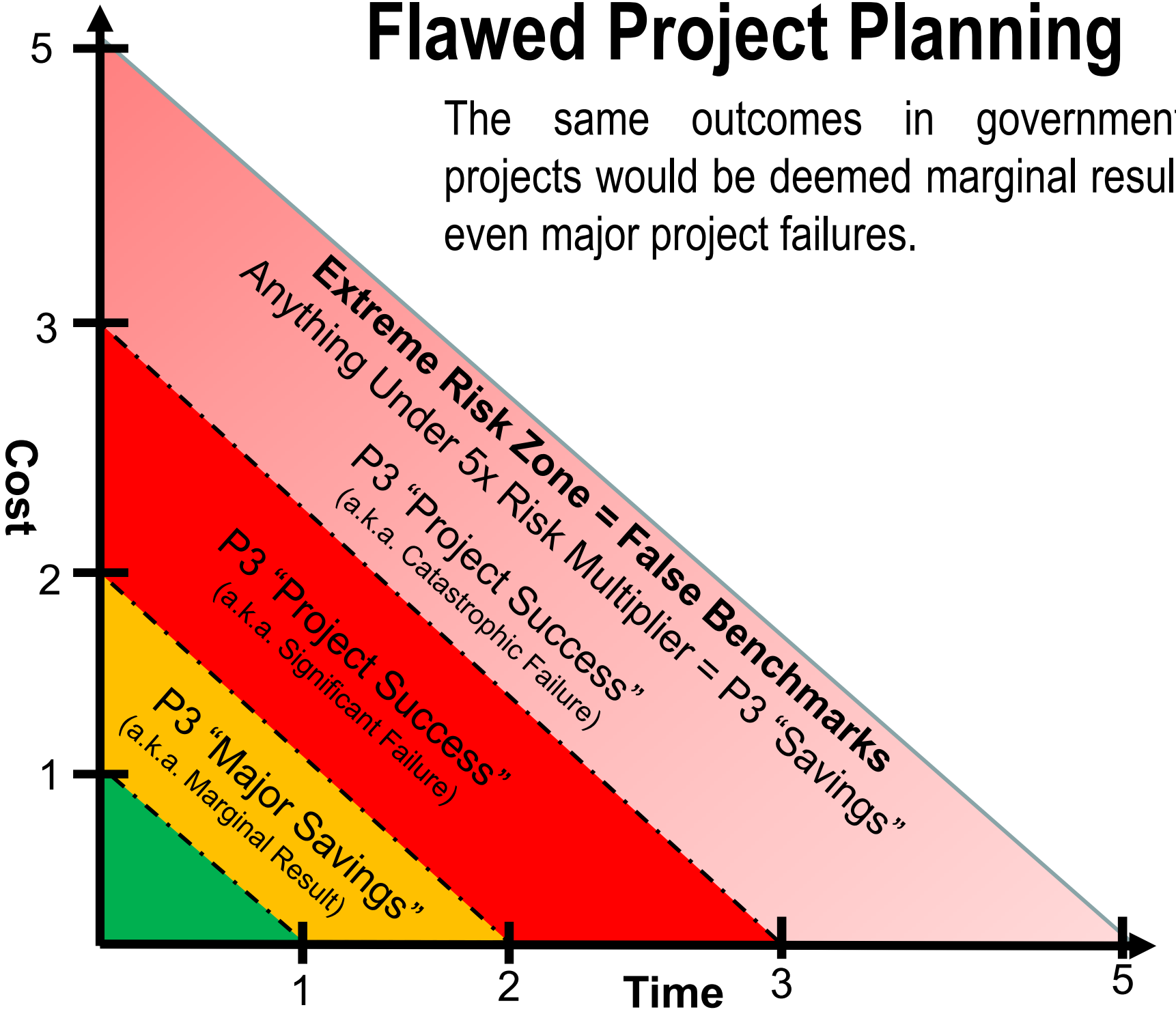
Flawed Project Planning

This false benchmark resulted in P3s being deemed “on time and on budget” when actual cost and delivery was less than five-times over the original estimates.



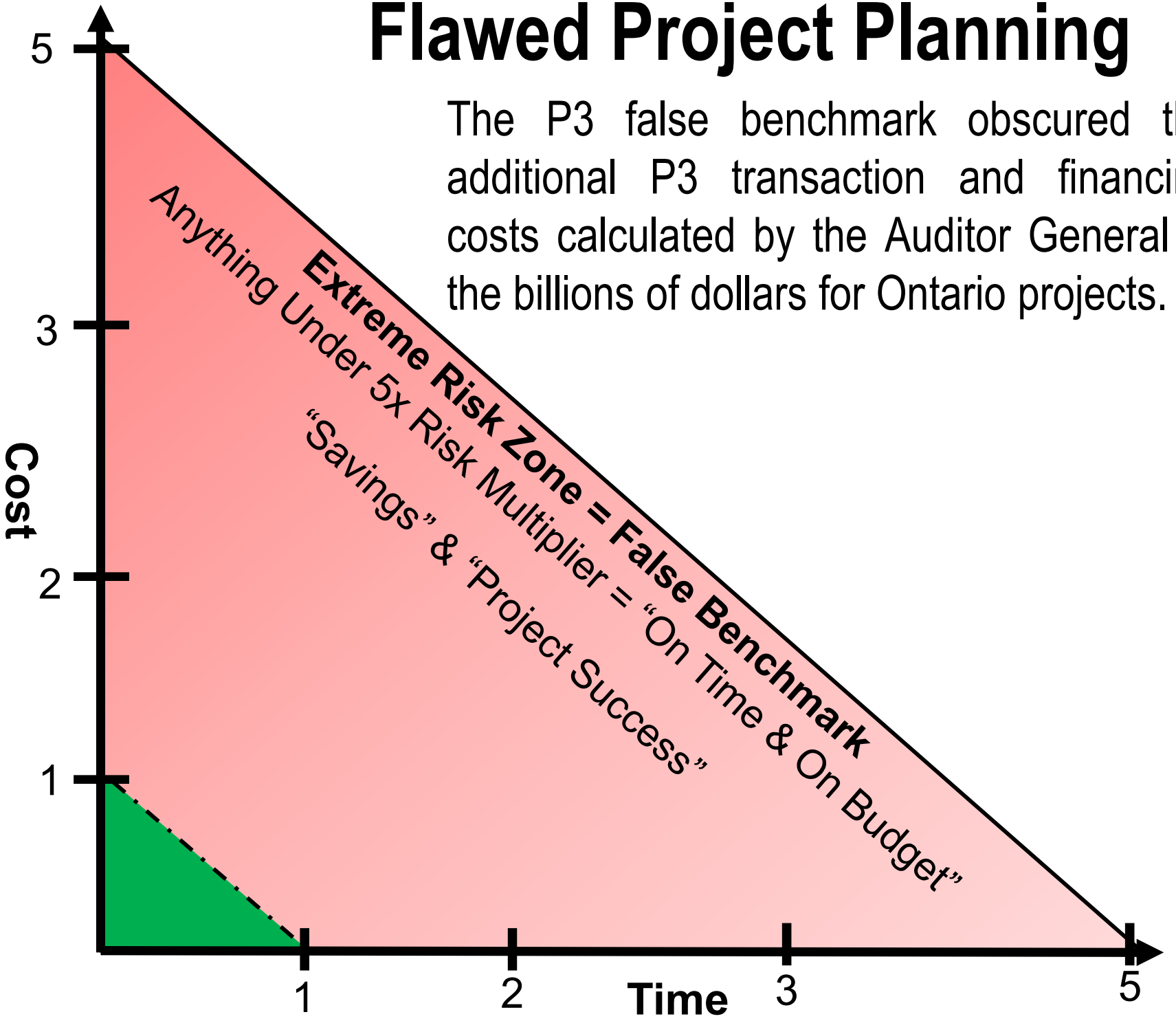
Flawed Project Planning

The same outcomes in government-run projects would be deemed marginal results or even major project failures.



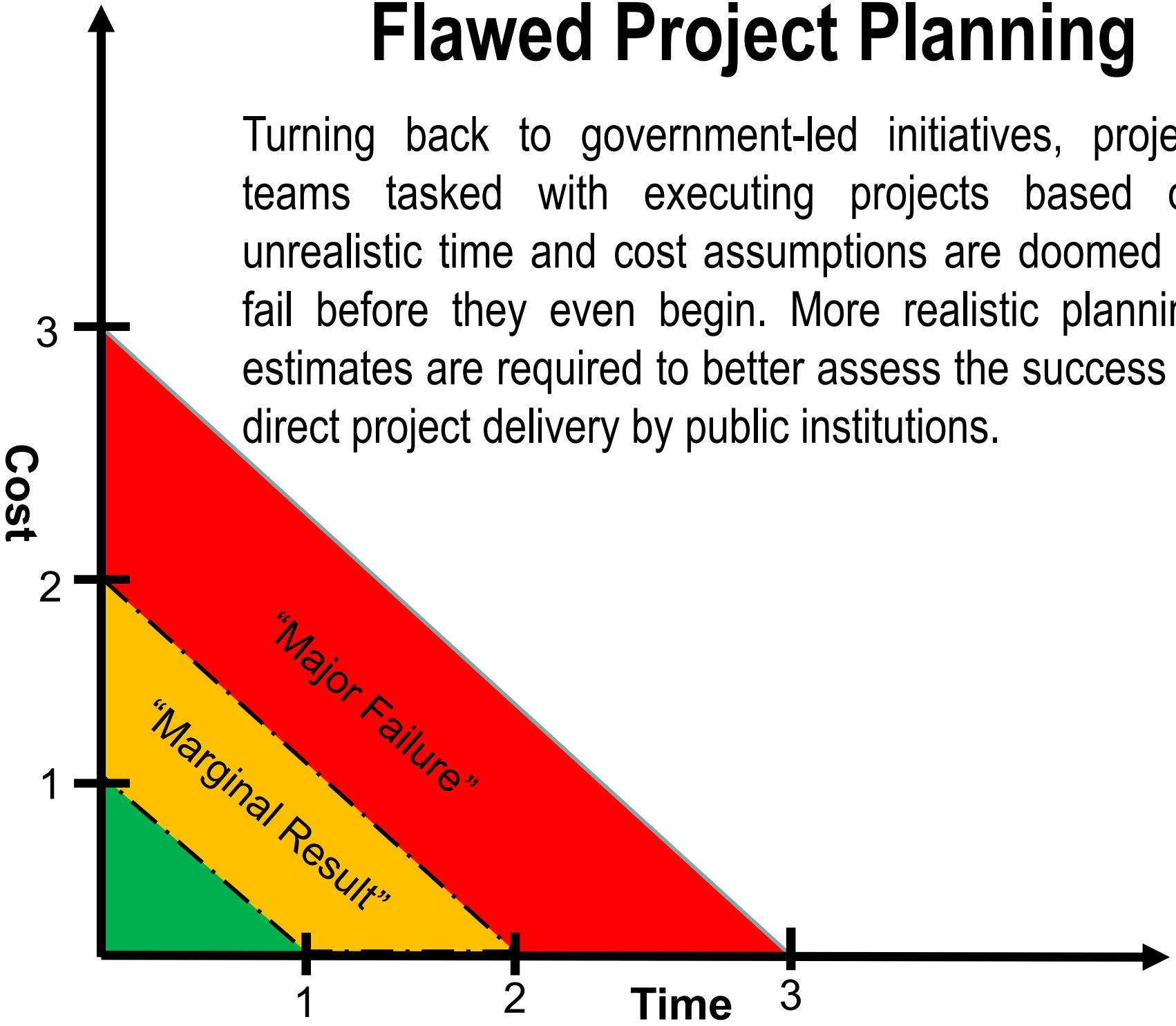
Flawed Project Planning

The P3 false benchmark obscured the additional P3 transaction and financing costs calculated by the Auditor General in the billions of dollars for Ontario projects.



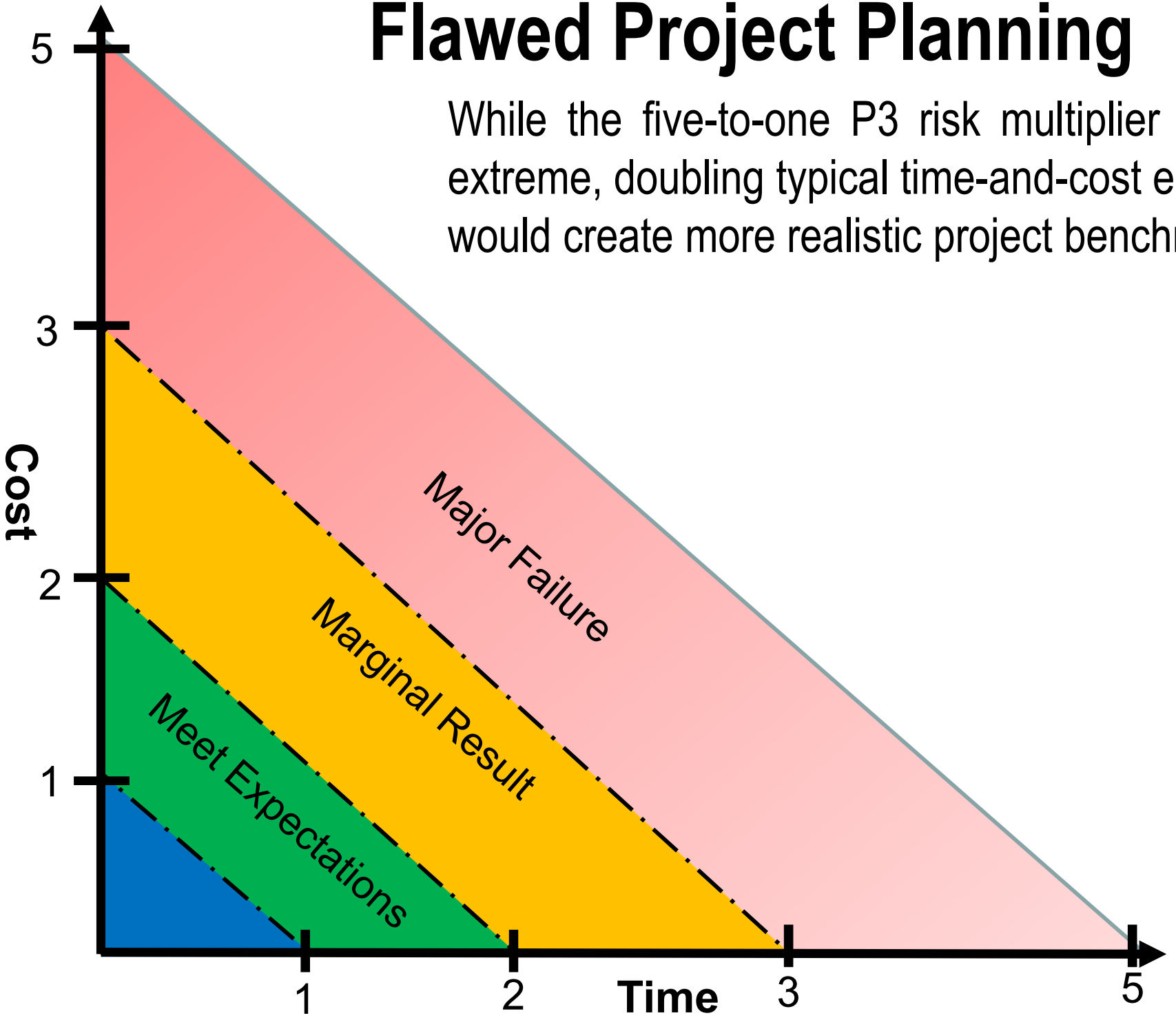
Flawed Project Planning

Turning back to government-led initiatives, project teams tasked with executing projects based on unrealistic time and cost assumptions are doomed to fail before they even begin. More realistic planning estimates are required to better assess the success of direct project delivery by public institutions.



Flawed Project Planning

While the five-to-one P3 risk multiplier appears extreme, doubling typical time-and-cost estimates would create more realistic project benchmarks.



The Five Inherent Risk Factors

Conclusion

Establishing more realistic cost-and-time estimates for major projects would put public institutions in a better position to assess whether their project teams missed, met, or exceeded expectations.

This in one example of how a better understanding of the **Five Inherent Risk Factors** can help improve the delivery of government-led major procurement projects.

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