

Public–private partnerships: international audit findings

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19.1 Introduction

This chapter discusses the findings on PPPs set out in audits performed by various national (or ‘supreme audit institutions’, as they are also called)¹ and regional audit offices. Audit offices play a key role in auditing government accounts and operations, and in promoting sound financial management and overall accountability in their governments. Thanks to their tasks and independent status, audit offices are ideally placed to supply the world of PPPs with hard facts based on empirical research.

19.1.1 Audit offices and PPPs

There is no doubt about the potential relevance of PPP projects as a subject for audit office reports. Massive public interests are often at play in such projects, in terms both of the (quality of) public services they seek to supply and of the public money invested in them. Although PPPs generally are privately financed, it is ultimately either taxpayers or consumers who pay for the cost of PPP projects. Value for money, regularity (i.e. the regularity of the expenditure on PPP projects) and, equally importantly, the accountability of PPP projects are all highly relevant issues for audit offices.

Basically, audit offices perform two types of audits: financial and regularity audits on the one hand and value-for-money (VFM) audits on the other. The former are connected with government accounts and are in many instances directed at the issuing of financial statements. The latter are all about the efficiency and effectiveness of government, its policies and its institutions. All audit offices perform financial audits, but there are variations in the extent to which they also perform – or are entitled to perform – VFM audits. Audits are usually performed ex post (after the fact).

19.1.2. Scope of the study

This chapter is based on a study of audit office reports on PPPs that we carried out in 2010. Our study was restricted to audit office reports on DBFM(O) concessions and similar projects.

Design, Build, Finance and Maintain (Operate) Projects are concessions under which the DBFM(O) aspects of a project (often infrastructural or a public utility) are contracted out to private-sector partners, usually under 25–30-year contracts and paid for by user or availability fees. In other words, no account was taken of audits of other types of PPPs, such as public-private alliances and conventional contracts (for example, outsourcing contracts) between public-sector and private-sector parties.

The main objects of our study were separate reports on PPP projects, or reports in which the PPP aspect played a key role. This meant that most of the reports we examined were on VFM audits. For this reason, the attention given to PPPs in regularity audits or audits directed at issuing financial statements on accounts published by public bodies was largely left aside. The distinction between regularity audits and VFM audits does not mean that no regularity aspects can come up in VFM audits.

The focus of this study lies on reports published by audit offices on PPP projects performed by the *national* government. During our research, we encountered a number of interesting studies by audit offices operating at regional (provincial or state) level. Where relevant, we have included their findings in our report.

We did not beforehand limit our study to a given period of time. Most of the reports we traced were published between 2000 and 2010, with the bulk appearing in the years 2008 and 2009. Our study was concluded mid-November 2010.

19.1.3 Study method

The reports used for this study originate from three sources: some were sourced directly from our international contacts, others were found on websites maintained by the various audit offices and others were provided in response to a mailing we distributed asking for information on PPP audits. In total we looked at 58 audit offices this way.

In the end we collected 48 relevant reports published by 21 audit offices (including both national and regional audit offices) in 13 countries. The number of audit offices around the world to have published reports on PPPs is not particularly large. We limited our study to reports or summaries of reports published in Dutch, English, German, French or Spanish. Most audit offices have versions of their websites in one of these languages, mostly English. Our survey may not include all relevant audit office reports in relation to PPPs. But we do believe that the picture our study paints is fairly representative for the findings of audit offices on PPPs.

In this study we refer to 38 of the 48 reports we used. Not because the others are not relevant, but because they don't add new findings and conclusions to those we give in this chapter. Also, referring to a certain report in this chapter does not imply that the same topic is not raised in another report; the various citations are just meant to illustrate the topic. There is a great similarity in findings and a great unanimity in standards and conclusions of the various audit offices.

Our analysis of the reports we collected shows, not surprisingly given the nature of the role played by audit offices, that most audit offices took a fairly critical attitude to PPPs. Although some reports do contain positive findings on PPP projects (e.g. Australia, New South Wales 2006; Australia, Victoria 2008), as a consequence this study concentrates on areas in which there is scope for improvement. But our study does not mean to give conclusions or an opinion on the use or sense of PPPs.

19.1.4 Reports on PPPs and audit offices

Our study covers audit reports from the following audit offices.

Table 19.1 Audit offices and reports

<i>Country (province or state)</i>	<i>Audit office</i>	<i>Website</i>	<i>Number of reports included in study</i>
Austria	Österreichische Rechnungshof	www.rechnungshof.gv.at	1
Australia, New South Wales	The Audit Office of New South Wales	www.audit.nsw.gov.au	2
Australia, Victoria	Victorian Auditor-General's Office	www.audit.vic.gov.au	2
Belgium	Rekenhof – Cour des Comptes – Rechnungshof	www.ccrek.be	2
Canada, Alberta	Office of the Auditor General of Alberta	www.oag.ab.ca	3
Canada, Nova Scotia	Office of the Auditor General Nova Scotia	www.oag-ns.ca	2
Canada, Ontario	Office of the Auditor General of Ontario	www.auditor.on.ca	1
Canada, Quebec	Vérificateur général du Québec	www.vgq.gouv.qc.ca	2
Czech Republic	Nejvyšší kontrolní úřad	www.nku.cz	1
Germany, Baden-Württemberg	Rechnungshof Baden-Württemberg	www.rechnungshof.baden-wuerttemberg.de	1
Germany, Bayern	Bayerischer Oberster Rechnungshof	www.orh.bayern.de	1
Germany, federal level	Bundesrechnungshof	www.bundesrechnungshof.de	3
Hungary	Állami Számvevőszék	www.asz.hu	5
India	Comptroller and Auditor General of India	www.cag.gov.in	8
Ireland	Office of the Comptroller and Auditor General	www.audgen.gov.ie	2
Lithuania	Valstybės kontrolė	www.vkontrolė.lt	1
The Netherlands	Algemene Rekenkamer	www.rekenkamer.nl	3
UK	National Audit Office	www.nao.gov.uk	2 (72)
USA, New York	Office of the State Comptroller, New York State	www.osc.state.ny.us	2
USA, Virginia	Auditor of Public Accounts, Commonwealth of Virginia.	www.apa.virginia.gov	1
USA, federal level	United States Government Accountability Office (GAO)	www.gao.gov	3

Most reports originate from Europe (22). Our list does not include any reports from South America or Africa. The UK's National Audit Office is by far the biggest producer of reports on PPPs, having published a total of 72 such reports on private finance initiatives, including a survey document of which we made extensive use for the purpose of our own study (UK 2009). Also several reports deal with more than one PPP project.

So what possible explanations can there be for the unavailability – or availability, as the case may be – of audit reports? Although this is not an aspect that we examined during our study the following factors – apart from the chosen method of stock-taking – may conceivably play a role:

- the national policy on PPPs: i.e. the number of PPP projects actually performed in the country in question;
- the mandate: certain audit offices may have mandates limited to perform only financial audits, or they may be subject to certain other restrictions in terms of their ability to perform VFM audits;
- priorities: audit offices may tend to focus on short-term public spending and, in parallel with this, assume that the degree of (financial) risk associated with PPP projects is relatively low;
- expertise: the complexity of PPP projects and the lack of specialist expertise available to the audit office in question.

19.1.5 Format of the chapter

This chapter sets out the findings of audit offices on:

- the pre-contract stage;
- financing and costs;
- contract management;
- political accountability;
- the evaluation of PPP projects;
- the policies and conditions that need to be fulfilled for PPPs to be successful.

The chapter ends with a number of concluding remarks on PPP and comments on the role played by audit offices in this connection.

19.2 The pre-contract stage

This section discusses the findings of audit offices on:

- the use of an added value test for assessing a PPP;
- the design of added value tests, and its inherent limitations;
- the way added value tests are used in practice, and the supporting evidence;
- the procurement phase.

19.2.1 Added value tests: not always used

Government policy in many countries is to ascertain whether carrying out projects, often of an infrastructural nature, as a PPP generates any added value compared with a situation in which the same project were to be performed by government. Despite this, a number of audit offices have found that such a comparison is not always made. In the Flanders region of Belgium, for example, the Belgian Court of Audit found that the public-sector contracting authority only very rarely performs an added value test to support its decision to have a given project performed either in PPP or traditional procurement (Belgium 2009: 12). The same applies to projects in India, Hungary, Canada and Lithuania examined by the relevant national audit offices: the decision to have the project performed by a PPP was not found to be

supported by any hard evidence (India 2008a: 39, 2008b: 9; Hungary 2006: 2–3, 2007a: 1; Canada, Ontario 2008: 104; Lithuania 2008).

It was the government of the day that decided to follow the public–private partnership approach. [. . .] The costs and benefits of alternative procurement approaches, including traditional procurement, were not adequately assessed.

(Canada, Ontario 2008: 104)

One possible explanation for the absence of these added value tests may be a desire to ensure that the financing for the projects in question is kept off the balance sheets (see section 1.3). In that case, using a PPP or an alternative form of private-sector financing is no longer a question of choice, but a precondition for the project.

19.2.2 Added value tests: inherent limitations

In the majority of countries on which audit office reports were available, added value testing – often performed in the form of a Public Sector Comparator (PSC) – did appear to form part of the standard procedure. Although there is a broad consensus that added value tests are ‘useful tools’, many audit offices are critical about the way in which they are used, pointing to certain *inherent limitations* that decision-makers tend to ignore in practice.

First of all, the results of an added value test depend (in part) on certain arbitrary assumptions and estimates of a large number of parameters whose value is uncertain. Examples of these include the scale and monetary value of risks (see section 3.2) and the discount rate used. The latter is the rate of interest used to calculate the net present value of the costs and benefits of a long-term investment project. In many cases, audit offices found that the discount rate applied was either too high or too low. They also noted that, the higher the discount rate, the more preferable a PPP seemed as compared with a conventional public-sector alternative, and vice versa.

It is recognized that the higher the discount rate used to convert to today’s dollars the cash flows associated with the two options, the more the PPP will appear preferable over a conventional public sector method, and conversely, because the PPP method permits for the spreading out of expenses over a longer period than does the conventional method.

(Canada, Quebec 2009: 16)

This could result in a situation in which an excessively high discount rate is used without good reason (Canada, Quebec 2009: 16).

The same mechanism applies to the amount and rating of the transferred risk to the concessionaire. The higher this is and the higher the discount rate the higher the added value of the PPP. The Austrian Court of Audit found in the PSC for a road project an inexplicable high transferred risk value compared to other countries and a consequently high added value for the PPP (Austria 2010: 33–7).

One of the problems at the choice of the discount rate is the absence of any sector-specific PSCs, which means that discount rates cannot be set with the specific circumstances of the sector in question in mind. The US Government Accountability Office notes in this connection that ‘discount rates used in PSCs to calculate the present value of future streams of revenue may be arbitrarily chosen by the procuring authority if not mandated by the government’ (USA 2008: 54).

Also, the long-term nature of PPPs (the contract periods are usually 25–30 years) does not add to the reliability of added value tests. This restriction is often neglected in administrative and political communications, and hence in the decision-making procedure. Also decisions are often based on a best-case scenario, without taking the worst-case into account. For example, in a report on the construction of a high-speed rail link, the Netherlands Court of Audit claimed that ministers were acting too hastily in writing to parliament about the project's 'proven added value', and stressed that this 'added value' was merely 'the highly uncertain result of a theoretical exercise' (The Netherlands 2002: 62).

Second, an added value test may not take certain costs into account. Our analysis of audit reports shows, however, that only a relatively small number of audit offices we looked at took account of the extra cost resulting from the use of new types of outsourcing as compared with the cost of conventional forms of outsourcing. The UK's National Audit Office is one of the few audit offices to point to this additional cost, which it says includes the additional cost incurred in raising loans and risk capital (i.e. equity and subordinate debt), a risk premium, transaction costs, the cost of complex tendering procedures and contract management costs (UK 2009: 22). The Netherlands Court of Audit also refers to transaction and management costs that are not factored into the cost of PPPs (The Netherlands 2002: 23, 62).

Third (and this is a fundamental point), added value tests are economic models that offer hardly any scope for factors of a qualitative or strategic nature. The Auditor General of Quebec (Canada) states in this connection that 'other factors, which are hard or impossible to quantify from a financial standpoint, may have an impact on the value of the options, and these advantages and drawbacks must be reviewed' (Canada, Quebec 2009: 17).

In the business cases of Montreal's University Health Centers, the qualitative analyses do not deal much with the drawbacks which the PPP method could entail (example: the uncertainty of the transfer of risks, the long-term survival of the private consortium, the flexibility to meet the needs) and the advantages of the conventional method.

(Canada, Quebec 2009: 17)

In other words, the outcome of an added value test should not be the sole factor that is taken into consideration when deciding in principle whether or not to opt for a DBFM(O) contract. As the UK's National Audit Office points out:

like any financial model, they cannot be relied upon as a sole source of assurance. Strategic issues can outweigh considerations of pure cost efficiency, but are unconvincing if they appear as *post hoc* rationalizations. They need to be clearly stated at the outset and built into the procurement process. When assessing private finance projects, we expect the public authority to have considered carefully whether there are strategic advantages or disadvantages from using private finance, such as: the need for a development to be operational by a particular date; the ability to access scarce skills; the desire of supporting particular parts of industry; the need for flexibility; or the inability to commit to long term current spending.

(UK 2009: 21)

19.2.3 Added value tests: often not enough supporting evidence

The UK's National Audit Office concludes that there is practical evidence to show that added value tests are prone to mistakes, manipulation and misuse (UK 2009: 20). Computational

errors, inaccurate estimates of parameters and the lack of good benchmarks may sometimes result in a PSC painting an overly flattering picture (Ireland 2004: 11–12). Equally, certain costs may be wrongly included in the cost of a public-sector project approach, or they may be overestimated (Canada, Ontario 2008: 104–5). Also, for instance, the estimate for the future use made of a road may be too optimistic (Austria 2010: 48). Because projects generally have a long life, even very slight variations in estimates can have massive financial consequences.

Another important observation is that the advantages of a particular proposal are often stressed without actually comparing the proposal with an alternative option, such as a fully conventional procurement and construction process (Belgium 2009: 34; Germany 2009: 41). The German Court of Audit emphasizes the importance of such a comparison (Germany 2009: 17–18). In some cases, the private-sector performance of a project in the form of a DBFM(O) contract is compared with fully traditional public procurement, but not with other options such as DB or turn-key contracts (Canada, Quebec 2009: 16).

It is interesting to wonder *why* so much goes wrong when added value tests are used. In certain cases, the PSC was conducted amid an overriding impression that it had already been decided that the outcome would be positive. Clearly, such an atmosphere is not conducive to the reliability of the test. At the same time, one should acknowledge the extreme difficulty of making a careful comparison between DBFM(O) contracts and their more traditional procurement counterparts. This is because of the large number of unknowns, the long life of the project, the high cost of mitigating the risks involved, and the difficulty of making accurate projections of future market prices. The problem is compounded by the absence of comparative data. Reliable figures are needed in order to calculate the cost of maintaining conventional building projects, and these should be based on the cost of comparable projects. Unfortunately, data on the latter may not be transparent, or it may prove that the projects themselves are not comparable (Germany, Baden-Württemberg 2009: 6, 40; Austria 2010: 24–5).

Nonetheless, notwithstanding the many criticisms levelled at added value tests, there is no reason to conclude that DBFM(O) contracts are by definition based on flimsier arguments or less reliable data than other types of contract. There is, after all, a shortage of studies comparing the merits of DBFM(O) contracts with those of conventional contracts in this and other respects. As the UK's National Audit Office points out, 'public authorities generally undertake greater scrutiny of the costs and benefits of PPPs than they do for other types of projects. In part, this is because there is greater guidance on what they need to do' (UK 2009: 45).

19.2.4 Procurement

Audit offices have performed many audits of the procurement processes of DBFM(O) contracts. The UK's National Audit Office writes that an effective tendering procedure is 'vital because the initial commercial terms often last throughout the life of the project' (UK 2009: 52–3). The National Audit Office reckons that the greatest threat to the 'value for money' arises 'during the final stage of negotiations, when negotiation is with a single preferred (or final bidder) and competitive tension is at its weakest' (UK 2009: 52–3).

Although a number of reports conclude that the procurement was 'fair and open' (Belgium 2009: 14, 63–4; Canada, Alberta 2010: 13), things sometimes go wrong. For instance, insufficient account may have been taken of the prevailing market conditions (Belgium 2009: 13, 47), or there may not have been enough competition for the contract (Lithuania 2008; The Netherlands 1993: 3).

The Court of Audit believes that the selection procedure used for raising finance for the Wijkter Tunnel . . .] did not provide sufficient guarantees that the outcome would be as beneficial as possible to the State. [. . .] The Court of Audit feels that the minister should have prevented a situation from arising in which she entered into a contract on the basis of a single tender without having any alternatives from which to choose.

(The Netherlands 1993: 3)

A frequently signalled problem in the audit reports we examined was the inadequate nature of the internal and external controls applied, particularly during the procurement stage. In some cases, the use of such controls would appear to conflict with the need for preserving the confidentiality of the projects in question. In expressing a positive opinion on the role of the special 'fairness auditor', the Auditor General of Alberta in Canada shows that controls and confidentiality are not necessarily in conflict with each other (Canada, Alberta 2010).

A Fairness Auditor was engaged to observe procurement processes and report on adherence to the fairness principles contained in the Management Framework: Procurement Process. The Fairness Auditor's interim and final reports concluded that the fairness principles were complied with. We tested conclusions contained in the Fairness Auditor's report. [. . .] Based on our work, we concur with the Fairness Auditor's conclusions.

(Canada, Alberta 2010: 27)

19.2.5 Summing up

Generally speaking, audit offices adopt a neutral stance on the *potential* for added value of DBFM(O) contracts. Audit offices tend, however, to be critical about the *use* of added value tests in calculating a contract's added value. For example, not all relevant costs are included in a PSC, there is often little scope for qualitative arguments and no full comparison may have been made with the alternative options. Audit offices also stress the importance of the procurement procedure, which should involve a sufficient number of competitive tenders and should be subject to adequate internal and external controls.

19.3 Financing and costs

The way in which PPP projects are financed, their costs calculated and the associated risks appraised are all common topics of audits, as are the issues of financial cost-benefit analyses and financial reporting. This section discusses a number of findings in relation to:

- off-balance sheet financing;
- risk appraisal and allocation;
- long-term financial obligations;
- costs of refinancing;
- asset values and ownership rights at the end of the project;
- competition and effects of the credit crunch.

19.3.1 Off-balance sheet financing: a spurious incentive

Governments have an incentive to design public-sector projects in such a way that the financing is kept off the governments' balance sheet, which means that obligations are not

capitalized in the accounts. Not only can this incentive result in the added value test being biased towards a PPP approach, as we have already pointed out, it can also lead to terms of PPP contracts being less than ideal.

The UK's National Audit Office described the pressure to keep projects off the balance sheet in its summary report published in 2009, in which it reported that 78 per cent of the PFIs (Private Finance Initiative) in the UK were financed by off-balance sheet methods (UK 2009: 35–6).

Public authorities often have no alternative source of funding and feel pressured to use private finance because its treatment in financial accounts and budgets make it seem more affordable from the public authority's perspective.

(UK 2009: 20)

Seventy eight per cent (£22 billion) of operational PFIs in England by capital value are not recorded on the balance sheet of public sector financial accounts and thus excluded from the Public Sector Net Debt statistics part of the National Accounts. Only 22 per cent (£6 billion) are on-balance sheet.

(UK 2009: 35–6)

Yet many public authority project and programme managers have continued to tell us that they feel pressure to shape projects so that they are off-balance sheet.

(UK 2009: 40)

The Hungarian State Audit Office found that 'choosing a PPP method has been justified by the high level of indebtedness, the attempts to decrease the deficit of the public finances and that in the course of the investments the Government would have liked to ensure also the advantages expected from PPP projects' (Hungary 2009: 1–2).

Off-balance sheet financing is attractive for EU member states as it makes it easier for them to comply with the EU's financial criteria. In the case of Spain, for example, off-balance sheet financing helped it to comply with the criteria for accession to the European Monetary Union (USA 2008: 20).

By keeping the capital costs off the public budget, Spain mitigated budgetary challenges and met macroeconomic criteria for membership in the European Union's Economic and Monetary Union.

(USA 2008: 20)

The same applies to the Flemish regional government in Belgium, which sees a clear link between PPPs and the financial requirements laid down by the EU (Belgium 2009: 25).

In this context, the Flemish Government regards alternative forms of financing, including PPPs, not just as an option, but as an indispensable tool in achieving its investment goals in an European System of Accounts-neutral manner.

(Belgium 2009: 25)

A number of audit offices report on the off-balance sheet financing of PPP projects by getting a separate legal entity to act as the contracting authority (e.g. Austria 2010; Belgium 2007). One example is the ASFINAG (*Autobahnen- und Schnellstraßen- Finanzierungs- Aktiengesellschaft*,

the ‘Motorways Financing Limited Company’) in Austria (Austria 2010: 14), where the State retains the legal title and the separate legal entity becomes the beneficial owner of the infrastructure, over which it has a right of usufruct. This means that the present and future costs of the PPP infrastructure are not visible on the government’s balance sheet.

The UK’s National Audit Office concludes that the desire to keep PPP contracts off the State balance sheet may create a risk that such contracts are drafted primarily with this in mind rather than with the primary aim of delivering the maximum VFM. This leads to less than ideal solutions such as limited public ownership, relatively low percentages of debt finance, relatively long-lasting projects and inefficient transfers of risk to private-sector parties (e.g. the transfer of inflation and residual risks) (UK 2009: 40–1).

The Belgian Court of Audit also concluded that there were not many occasions on which the government sought to achieve an optimum distribution of risks for the purpose of effective risk management. According to the Belgian Court of Audit, risks were allocated virtually for the exclusive purpose of keeping the financing off the government’s balance sheet. More specifically, although the construction and availability risks were transferred to the private-sector partner, in certain cases, the risk associated with the volume of investment was also transferred to the private-sector partner, even though this is a risk that the Flemish regional government is best placed to manage (Belgium 2009: 13).

Financial reporting standards clearly play a role in deciding whether PPP projects should appear on the government’s balance sheet and, if so, how. The UK’s National Audit Office points out that the adoption of the International Financial Reporting Standards (IFRS) means that PPPs are now more likely to appear more regularly and more clearly on the government’s balance sheet (UK 2009: 42). This should put an end to the spurious incentives to keep them off the balance sheet.

IFRS replaces UK GAAP’s focus on the balance of risk with a focus on the balance of control. This means that a public authority’s accounts will record the asset and liability of a PFI project on a balance sheet where it:

- 1 controls or regulates what services the contractor must provide with the PFI asset, to whom it must provide them and at what price; and
- 2 controls any significant residual value interest in the fixed asset at the end of the arrangements (e.g. the public authority can control the use of the asset at the end of the contract, perhaps by an option to purchase it at a set price).

In practice, we expect that nearly all PFI projects will be on the published balance sheets of the individual public bodies after the implementation of IFRS.

(UK 2009: 42)

A problem, however, is that the IFRS are not based on the same principles as those underlying the EU’s reporting standards, the European System of Accounts (ESA 95). This means that the information on the risks and obligations pertaining to PPPs distributed at a European level continues to be incomplete.

ESA 95 is produced by the European Commission to standardize economic statistics between EU Member States. ESA 95 is in turn consistent with the System of National Accounts, which was prepared under the auspices of the United Nations and is used globally. [. . .] ESA 95 determines the treatment of PFI projects on the basis of the balance of risk. [. . .] We expect that, whilst nearly all PFI projects will be recorded on the balance

sheets of their public client's accounts, the majority will not be included in statistics of Public Sector Net Debt. This removes the incentive to shape projects against the detailed financial reporting standards to ensure that they are off-balance sheet in the accounts.

(UK 2009: 42)

19.3.2 Risk appraisal and allocation

A clear specification, appraisal and allocation of the risks associated with a PPP project are absolutely vital for its success and added value. Many of the audit office reports on PPPs devote a considerable amount of space to this aspect. One of the few audit offices to take a positive view is the Office of the Auditor General in Alberta (Canada, Alberta 2010: 20).

The systems demonstrated that risks were transferred to, or retained by, the party who could most cost-effectively manage the risk. Risk was appropriately allocated between the province (departments or school jurisdictions) and contractors.

(Canada, Alberta 2010: 20)

The majority of audit office reports we used in our study, however, contain critical comments on the way in which risks are appraised and apportioned. A number of these risks are discussed in more detail below.

19.3.2.1 Risks are not clearly defined

The Belgian Court of Audit concluded, for example, that the government did not perform full risk analyses in relation to the majority of PPP projects. As a result, the Court believed that the government departments in question were also not well placed to negotiate on the terms of the contract (Belgium 2009: 13). A failure to clearly define the risks involved may induce parties to try and foist their responsibility onto others or to offer non-standard prices. The Auditor General of Quebec came to a similar conclusion (Canada, Quebec 2010: 4). In two reports on toll tunnels published in the early 1990s, the Netherlands Court of Audit concluded that only a limited amount of the risk involved had been transferred to the private sector. The State still bore responsibility for the bulk of the risk associated with larger traffic flows (The Netherlands 1990: 1993).

19.3.2.2 Risks are dependent on other parties

In a report on a high-speed rail link, the Netherlands Court of Audit found that, although the government was responsible only for two significant types of risk (the risk of traffic flows being lower than projected, and the risk of policies and legislation being amended), in certain cases the government would still foot the bill even if the private-sector party in question failed to discharge its contractual obligations. This is because the private-sector party is dependent on the performance of other parties (The Netherlands 2002: 71). This is known as the 'interface risk'.

19.3.2.3 Subcontracts cause risks to transfer back to the government

In some cases, subcontracts have the effect of causing certain risks to transfer back to the government, even though the government continues to pay for their mitigation. This was a

finding of the Auditor General of Nova Scotia, Canada, for example, in an audit he performed of service contracts for schools (Canada, Nova Scotia 2010: 27).

Two developers subcontracted their responsibilities under their service contracts for certain schools to the regional school boards. These subcontracts effectively transfer the risks for the operation and maintenance of the schools assumed by the developers in the service contracts back to government.

(Canada, Nova Scotia 2010: 27)

19.3.2.4 No advantages compared with conventional contracts

The Bavarian Supreme Court of Audit analysed the way in which the risks had been appraised and managed in a road construction PPP project that was intended to act as a pilot scheme for future projects. It concluded not only that the way in which risks are appraised and managed in a PPP contract does not offer any advantages over a conventional contract, but also that risks such as those pertaining to cost rises or project management could easily be managed by smart conventional types of contract (Germany, Bavaria 2006: 7, 53, 61).

19.3.3 Long-term budget inflexibility

A number of the audit offices whose reports we studied also cited the long-term nature of the project funding as a risk. The Bavarian Supreme Court of Audit describes as one of the drawbacks of PPPs the fact that they create certain long-term financial obligations which severely curtail the government's room for manoeuvre (Germany, Bavaria 2006: 62).

Every PPP project is based on a direct loan and creates long-term financial obligations for the future, thus restricting the government's future freedom of movement accordingly.

(Germany, Bavaria 2006: 62)

The Court of Audit in Baden-Württemberg also referred to the risk of saddling future generations with high costs due to the fact that PPP projects have a long lifespan (Germany, Baden-Württemberg 2009: 46–7).

The Court of Audit [also] warns about the increasing strain that is placed on future budgets by PPP projects governed by contracts usually lasting between 20 and 30 years (known as 'grey debt'). Therefore, the state budget needs to be made more transparent by including clear information on this point.

(Germany, Baden-Württemberg 2009 press release: 4)

19.3.4 Costs of refinancing

The UK's National Audit Office warns that the government must be careful not to lose money when refinancing loans or attracting new investors (UK 2009: 57):

The NAO recommended in its review of refinancing that authorities assess the impact of refinancing proposals on the future of the project. Factors to consider are particularly service delivery incentives, increased termination liabilities, and the impact of receiving the gain over time if the contract is terminated. [. . .] New sharing arrangements appear

to be working well, but there have been exceptions. We criticized one of the early refinancings, the Norfolk and Norwich PFI Hospital, for only securing the NHS Trust 29 per cent of the £116 million refinancing gain, whilst increasing the contract's termination costs.

The investors may change during the course of the project, and the government must be alert to the motives attracting investors to the project (UK 2009: 58).

The development of the secondary market was described in an NAO report on refinancing and the equity market. [. . .] In terms of managing PFI contracts, public authorities need to be aware that investors in their projects may change. The authorities should make sure they understand the business drivers of any new investors.

(UK 2009: 58)

19.3.5 Asset values and ownership rights upon completion of the project

A number of audit offices also discuss the transfer of projects to the government at the end of the contract period. For example, they highlight the importance, in a situation where the government is planning to acquire the ownership of a project at the end of the contract period, of reaching a clear agreement beforehand on the state of the facility to be handed back and on the valuation principles used (Australia, New South Wales 2009: 4; Canada, Nova Scotia 2010: 40, 45). There may be a risk that, if the principles on which the appraisal is based turn out to work against the government's interests, thus resulting in an excessively high purchase price, the government has in fact no choice other than to extend the contract or terminate and vacate the project (Canada, Nova Scotia 2010: 40).

19.3.6 Effects of competition and credit crunch on PPPs' VFM

Innovative forms of outsourcing such as DBFM(O) contracts generate value for money only in a competitive market. The UK's National Audit Office points out that markets, including financial markets, are by no means always competitive: 'Since the credit crisis, there have been particular difficulties in achieving competitive financing' (UK 2009: 20). Similarly, the recent downturn in global financial markets created sometimes uncertainty about the receipt of promised donations by private sector parties (Australia, Victoria 2009: 52).

The credit crunch has also resulted in a relative rise in the cost of borrowing for private-sector parties, thus making PPP contracts more expensive. The UK's National Audit Office claims that, in order to generate value for money during the credit crisis, it may sometimes be necessary to look for both additional sources of finance and potential savings, or else to reappraise the risks involved in the project (UK 2009: 31–4).

This fall in the swap rate has offset some of the increased margins. The NAO does not hold data on the finance costs of projects it is not auditing. It is thus difficult for us to be precise on what the overall effect has been. However, based on our talks with stakeholders, we estimate that the absolute nominal cost of private finance is (roughly) in the region of 30 to 130 basis points higher in 2009 than it was before 2008. This has decreased the affordability of projects.

(UK 2009: 32)

19.3.7 *Summing up*

With one or two exceptions, the audit office reports we studied are all highly critical of the financing and the cost aspects of PPP projects. Both the costs and the risks are kept off balance sheets; cost calculations are not complete; alternative options are not examined on an equivalent basis; and the government still bears an excessive proportion of the risks involved and hence all too frequently ends up footing too much of the bill.

19.4 **Contract management**

This section looks at the audit findings on the management of PPP contracts. The following issues are addressed:

- the importance of good contract management;
- performance monitoring;
- staff competence;
- contract changes.

19.4.1 *The importance of good contract management*

No matter how good a contractual deal is, it is highly unlikely to achieve value for money if it is poorly managed. According to the Auditor-General of New South Wales, Australia it is becoming increasingly evident that in order to maximise effectiveness, PPPs need to be well managed throughout every phase from establishment of the project deed, through operation and finally to handback (Australia, New South Wales 2009: Foreword; Australia, Victoria 2008: 3). The UK's National Audit Office reports however that contract management is not a high-priority issue in relation to PPP projects (UK 2009: 9, 59).

But a culture continues to exist across much of the public sector of exclusive focus on making the deal. This is in part because much of the VFM of a PPP is established in the planning, tendering and commercial terms embedded in the contract. It is also due to the influence of bringing in technical, legal and commercial advisors whose role it is to ensure that the contract is based on the right commercial terms, and the pressures of negotiation. [. . .] The culture of making the deal has led to the neglect of contract management issues.

(UK 2009: 58–9)

That project management is a recurring problem is clearly illustrated by the delays affecting DBFM(O) projects in practice and by the failure of certain projects to comply with the relevant technical specifications (India 2008a: 39; Czech Republic 2008 press release; UK 2009: 10).

19.4.2 *Shortcomings in performance monitoring*

Monitoring is a key aspect of good contract management. Monitoring enables the contracting authority to ascertain whether the preset targets have been met and whether the PPP is delivering the agreed goods and services, i.e. whether it is performing in accordance with the agreed contract terms. The audit offices involved in our study regularly encountered shortcomings in both the planning and the execution of monitoring activities.

In some cases audit offices found that the underlying contract gives the government the tools it needs to monitor the degree to which the PPP is complying with the contract terms (e.g. The Netherlands 2002: 71). In many cases, however, they found that the underlying contract either does not contain any monitoring clauses or contains monitoring clauses that are inadequate (e.g. Canada, Nova Scotia: 38; USA, New York State 2002: 14–15). As a consequence, the public authority may not have access to important information it requires to ensure compliance with contract terms (e.g. Canada, Quebec 2010: 38).

Comprehensive contract terms and management processes and procedures which ensure services paid for are received are essential to protecting the public interest. Our audit identified significant weaknesses in both of these areas. As a result, we cannot conclude on whether key calculations supporting contract payments are correct or whether many services paid for are received.

(Canada, Nova Scotia 2010: 27)

Audit offices also found that, even when contracts do contain clauses on performance management and monitoring, the systems are not always well designed (e.g. Hungary 2007a: 2). The UK's National Audit Office points out in this connection that:

[performance management systems] are difficult to get right, needing to be both well calibrated and managed. Whether services meet an operating specification can involve subjective judgements, such as the meaning of 'clean' in a hospital or the acceptable level of incidents of self-harm in a prison. [. . .] In other situations performance indicators may be misleading or lack objectivity.

(UK 2009: 55)

Furthermore, audit offices sometimes conclude that, even where the underlying contract contains effective monitoring clauses and a well-designed system of performance management, the monitoring activities and internal controls may not actually work or work properly in practice (e.g. USA, New York State 2002: 5, 14; Ireland 2006: 95).

The responses to the audit questionnaire, and the subsequent discussions with the principals of the project schools, raised some doubt as to the extent to which the required maintenance and management services are fully provided. That gives rise to the issue of whether the verification procedures, currently followed by the Department, provide adequate assurance regarding the full delivery of contract services. [. . .] There would appear to be insufficient communication between the Department and the project schools with regard to performance issues.

(Ireland 2006: 95)

One of the main problems is that the public authority may not be sufficiently reliant on receiving negative feedback. This may be the case, for example, if staff fail to report faults (UK 2009: 55) or if it is wrongly assumed that the standard of performance must be right as long as users do not complain, even though the users are not actually aware of the detailed service level requirements specified in the contracts (Canada, Nova Scotia 2010: 27–33).

Another interesting finding in this connection is that the government may undermine the success of performance management not just by being *too remote* from the project, but actually by being *too close* to it. For example, the Hungarian State Audit Office found that local

authorities were so heavily involved in the operational management of a PPP that it was difficult for them to hold the private-sector partners to account for any non-compliance (Hungary 2009: 1–2).

In practice, however an operational practice has taken place, contrary to the original operation contracts in the course of which the local governments representing the public sector and/or their economic companies have mostly taken over the operational tasks or part of them from the private sector. Their taking a direct or indirect role in the operation (via their economic companies) has decreased the possibility of calling the private partners to account for the level of providing public tasks.

(Hungary 2009: 1–2)

Performance regimes (i.e. payment schedules) that outline service levels and apply penalties to providers if they fail to live up to them are potentially powerful tools for controlling contract performance. However, audit offices observe that authorities in practice fail to impose penalties for deficient/non-performance despite the fact that there are relevant clauses in the concession agreements (India 2008b: 30; UK 2009: 28).

One reason for few penalties is that public clients do not always enforce the contract. Sometimes penalties are offset for other services rendered or suspended as part of a plan to work together to improve performance. Sometimes public clients fear that applying penalties will harm their relationship with the contractors and cause further performance degradation. [. . .] The NAO does believe that public authorities should only waive a penalty where this achieves a higher benefit than the penalty, and after consideration of any moral hazard. [. . .] The main reason for few penalties, however, is likely to be that most project managers report satisfaction with operational performance. [. . .] High levels of satisfaction are also normally reflected in our reports and surveys of users. There may be a risk of bias in project managers self-reporting their satisfaction level. Their views, however, remain an important barometer of performance.

(UK 2009: 56)

19.4.3 Shortage of competent staff

One of the risks inherent to good project management and performance monitoring is that there may not be enough competent staff working for the public authority in question, and also that there may be a lack of continuity in this connection. This aspect is regularly stressed in UK's National Audit Office publications, according to which:

a lack of staff continuity from the tendering to the contract management stages makes it harder to achieve a high standard of contract management, and causes a loss of technical and commercial knowledge. A change in staff makes it harder to establish effective relationships between the public authority and the contractors. [. . .] Some public authorities do not employ a full-time contract manager, leaving key risks unmonitored and unmanaged. There is a shortage of the commercial and project management skills needed to manage private finance and other major complex projects across government. There is insufficient training for contract managers across government, and limited career structures.

(UK 2009: 59)

One popular means of compensating for the lack of expertise and continuity is the use of external consultants. The 'effective use of advisors brings many benefits, including the spread of skills between projects and the provision of key skills at specific points. But it can lead to higher project staff costs; departmental staff not taking responsibility for commercial decisions; and commercial knowledge of projects being lost when they leave' (UK 2009: 55).

Other audit offices in addition to the UK's National Audit Office also point out that, in order to effectively monitor performance and contract compliance, the executive agency that the public authority needs to maintain during the life of the contract has to meet extremely high standards in terms of organisation, expertise and continuity. For example, the Netherlands Court of Audit concludes that, in the case of a high speed rail link project, the government was in fact dependent on external expertise for the effective management, monitoring and control of the project's operational stage (The Netherlands 2002: 45, 76). Other audit reports suggest that proper tendering procedures are not consistently used for recruiting external consultants and that the (often high) cost of engaging external consultants is not always included in price comparisons (Canada, Ontario 2008: 105).

19.4.4 Changes place pressure on added value

Audit offices found that amending a PPP project after the contract has been signed often creates problems and in many cases raises the cost of the project so much as to jeopardize its added value. This may be due to deficiencies in planning. As the Office of the Auditor General of Ontario in Canada reports, 'part of the cost involved in modifying the facilities for the installation of equipment could have been avoided with better planning' (Canada, Ontario 2008: 105). But at the same time, the long life of projects means that changes during the operational or maintenance stage are often unavoidable. Nonetheless, it is clear from audit reports that the government does not always get value for money from such changes. For example, the government sometimes wrongly decides not to follow public procurement procedures in the case of major changes and, in many cases, the private-sector party in question charges an additional management fee which 'may not be justified by the work needed to process the changes' (UK 2009: 56). Finally, it is often difficult to work out how the costs of certain changes have been calculated, and hence whether they are realistic. For this reason, there is a greater risk of legal proceedings in relation to such changes (Austria 2010: 13–14).

19.4.5 Summing up

Audit offices found shortcomings in both the planning and execution of contract management. One of the problems in this connection is the difficulty of formulating good performance indicators. In some cases, the underlying contract does not contain adequate monitoring clauses. However, there are also instances in which, even though a good system of performance management has been put in place, monitoring and internal controls still prove inadequate in practice. The shortage of competent staff employed by public authorities is a factor here. Audit offices also found that changes made during the course of a project place the value for money under pressure. It emerges from the analysis that enforcing all the elements of PPP contracts is essential. Also monitoring of the execution of contracts with full access by the public sector to relevant information is crucial for the success of PPPs.

19.5 Political accountability

Parliaments can be involved in PPP projects at different times and in different ways. Their role may take the form, for example, of a decision in principle on whether or not to perform the project in question as a PPP, a 'go or no go' decision during the contract negotiations, or as the recipient of progress reports. This section examines the findings of audit offices in relation to the role played by parliament. The following issues are addressed:

- the influence exerted by parliament on the contract terms and negotiations;
- the transparency of budgetary information;
- the progress reports submitted to parliament.

19.5.1 Lack of parliamentary influence on contract terms and negotiations

Not much research has been performed into the role played by parliaments during the preliminary stages and the contract negotiations. The Netherlands Court of Audit is an exception from the rule, having concluded in an audit report on a high-speed rail link – a € 2,3 billion contract – that the Dutch parliament was not sufficiently informed on financial analyses, risks, changes in scope and the claimed efficiency gains of the contract (The Netherlands 2002: 80–1). In its audit the Court also found that the relevant policy documents did not contain arrangements on the negotiating mandate of the responsible minister, or on the explicit right of the House of Representatives to approve the draft contract (The Netherlands 2002: 36–37). This had the effect, the Court concluded, of undermining the House of Representatives' supervisory function and right to amend and approve the government's budget.

In responding to these conclusions, the government said that the State's negotiating position would have been seriously undermined if the House had been informed on certain aspects of the contract and be able to alter the outcome of the negotiations (The Netherlands 2002: 81–2). The Court of Audit stated that it is possible to involve and inform parliament in a smart, effective manner, without becoming embroiled in technical, legal or financial details, and without undermining the State's negotiating position (The Netherlands 2002: 82).

19.5.2 Limited transparency of budgetary information

A number of audit offices, the Dutch and Belgian audit offices in particular, criticized the lack of transparency in the budgetary information on PPP projects. For example, the Netherlands Court of Audit claimed that the way in which the cost of PPPs was budgeted and the risks were allocated was at odds with conventional budgetary methods (The Netherlands 2002: 25):

The budget is limited to investment periods of five years, whereas PPP projects last 30 years and are priced on the basis of the life-cycle cost. Moreover, PPP projects involve the transfer to private-sector parties of certain risks for which the government would not make any charge were it to retain responsibility for them.

The Belgian Court of Audit made a similar comment in 2009, when it said that the budgetary information on PPP projects was 'insufficiently complete and clear'. According to the Court, the reports did not provide sufficient clarity about the extent to which 'the payment obligations – which last beyond the end of the present legislature and also extend beyond the horizon of the multiannual budget – are already restricting the government's future room for

manoeuvre in terms of policy-making. Insufficient information is provided on government shareholdings' (Belgium 2009: 15).

19.5.3 *Incomplete progress reports to parliament*

In certain cases, parliaments receive regular progress reports from the government, including a list of current PPP projects. For example, the British government reports to parliament twice a year on the long-term obligations arising from PFI projects. Acting in collaboration with the UK's National Audit Office, the Treasury (the UK's Finance Ministry) has drawn up guidelines for reporting to parliament (source: PPP, The government's approach, 2000: 33, in: The Netherlands 2002: 25).

PPP contracts are long-term contracts generating payment obligations over a number of years. In Belgium, although the Flemish regional government's long-term obligations are authorized in the form of budget decrees, a large number of PPP-based obligations are incurred by independent agencies and are hence not authorized by budget decrees (Belgium 2009: 15).

A number of audit reports claim that the information given in progress reports is at times incomplete and does not go into specific problems affecting the project in question (The Netherlands 2002: 37; Belgium 2009: 15). The Belgian Court of Audit concluded, for example, that the information in the first two reports that the Flemish regional government presented to the Flemish parliament (situation as in 2009) on current PPP projects and other programmes funded by alternative finance initiatives was not entirely complete (Belgium 2009: 15).

For example, the reports do not contain any information on PPP initiatives that have either been terminated or refocused. Moreover, basic terms such as the 'sum invested' are interpreted differently in the various project forms and no accurate explanation is given of the differences between a 'planned decision', a 'decision that has already been taken' and 'a decision that has been put into effect'. The information has not been adjusted to the budgetary documents: it does not contain any clear multi-year table showing all future annual costs accruing from all commitments. No clear distinction is made between basic information and recent developments. Although the Flemish regional government provided more streamlined information on the various projects in the third report, published in December 2008, the information was not entirely up to date.

(Belgium 2009: 15)

19.5.4 *Summing up*

We found that most audit reports published on PPPs by audit offices did not look at the way in which parliament is kept informed, nor at the opportunities open to parliament for influencing the terms of PPP contracts. But the audit offices that looked at this matter found that there is scope for improving the way in which budgetary and reporting procedures are used for informing parliament about PPPs. They were very critical: a great deal of financial information remains outside the routine budgetary and reporting procedures.

19.6 The evaluation of PPP projects

Reliable, thorough evaluations during and after the project are crucial if governments are to learn from PPP projects and improve their policies. Evaluations can be performed at various

stages of a project and may relate to certain discrete project stages. For example, they may cover the procurement procedure, the operational stage or the entire process. This section discusses the following topics:

- practical and methodological difficulties encountered in performing evaluations of DBFM(O) projects;
- providing evidence of the added value inherent to DBFM(O) projects.

19.6.1 *Government evaluations and analyses often absent or incomplete*

The reports published by audit offices show that, in practice, the evaluations produced are often not good enough to provide a basis for support or as input for learning.

First of all, the performance of a project evaluation is not always part of the standard project procedure. This is a missed opportunity for governments to learn from their mistakes. The UK's National Audit Office does not mince its words, concluding that 'a lack of systematic evaluation of operational projects results in missed lessons and means that the costs and benefits commonly assumed in business cases remain largely unproved' (UK 2009: 20).

A second problem is the absence of measurable project objectives or policy aims, which makes it difficult to perform good evaluations in practice. This is just as much a problem for the audit offices themselves, which do not have any objectives they can use as reference points for their audits.

The documents supporting the decisions in principle taken by the Flemish regional government refer to the policy objectives the PPP projects are supposed to help achieve. However, the specific objectives formulated for the projects in question are not sufficiently SMART to enable a policy review to be performed after the completion of the projects.

(Belgium 2009: 33)

A third problem for both evaluators and auditors alike is the absence of relevant data and reference material (see subsection 19.1.2). For example, there is still a shortage of good cost analyses at present, because data are often not collected in a systematic way. This means that it is not possible to make a good comparison between different types of contract or different methods of government procurement. The UK's National Audit Office reports that:

the main reason that we have not seen such costs comparisons is because departments do not collect data on whole-life costs of projects in a systematic way: central government rarely collects data from local government-funded projects or a devolved funding; PPP costs are rarely collated centrally and, where they are, they are hardly ever updated for contract variations; the costs of ongoing services for conventionally procured buildings are rarely monitored, making whole-life costs very difficult to compare; different procurement routes collect data on different bases

(UK 2009: 49–50)

19.6.2 *Too little hard evidence of added value generated by PPPs*

Partly because of the absence of sufficiently robust evaluations, there is still no hard evidence to show that DBFM(O) projects represent the most efficient form of government procurement. Not surprisingly, many audit offices are critical about the promises made about

DBFM(O) projects. The tone of many reports is that, whilst there are clearly potential benefits to be gained from using PPPs, there is no reason, in the light of the practical problems, to assume that these benefits will automatically accrue.

We find that using private finance brings benefits, but these cannot be counted on. Our reports assess VFM at a particular point in time. That may be after contract letting or at some stage during the contract's operation. Based on these snapshots, we have found some projects which have the potential to be VFM, some where the VFM is uncertain, and some where the project has failed to achieve VFM, normally because it was tendered or managed poorly. [. . .] It is easier to count the failures: a fifth of the projects we have examined have clearly failed to achieve VFM, normally due to poor tendering or contract management.

(UK 2009: 19)

Various audit offices have attempted to ascertain whether PPPs are in effect cheaper than a public-sector alternative. Some reached a cautiously positive conclusion. For instance the Hungarian State Audit Office, which performed an audit of a PPP formed to provide student accommodation, concluded that the use of a PPP had resulted in any event in lower maintenance costs (Hungary 2007b: 1–2).

Per-unit maintenance costs are lower at the newly constructed dormitories and the reconstructed residence halls than at the traditionally run residence halls.

(Hungary 2007b: 2)

On the other hand, the UK's National Audit Office claims there is no evidence to support the assertion that the whole-life cost of PPPs is lower than that of conventional contracts (UK 2009: 27).

PFI provides a contractual guarantee that the public client will fund the ongoing maintenance of the building. This has generally meant higher annual maintenance costs than previously and less budgetary flexibility. [. . .] Whether it will lead to an overall reduction in whole-life costs would be very difficult to prove.

(UK 2009: 27)

The Bavarian Supreme Court of Audit even concludes that PPP road construction projects did not actually generate any efficiency gains that could not have been obtained with conventional procurement methods (Germany, Bavaria 2006).

The Bavarian Supreme Court of Audit summarizes the results of its audits as follows: a realistic cost comparison cannot identify any benefits of a PPP over a conventional solution. Cost savings arise if construction work proceeds without any delays. This would also have been possible if the conventional method had been used. The same applies to the cost advantages in using a general contractor as compared with breaking the project down into separate components in accordance with the procurement guidelines.

(Germany, Bavaria 2006: 62)

Although PPPs are expected to improve the manageability of costs and reduce the risk of budget overshoots, a number of audit offices did identify instances of overspending and

higher-than-estimated project costs (e.g. Czech Republic 2008 and Canada, Quebec 2010). These may be the result of changes in criteria or conditions, but equally they may be due to a failure to take account of all relevant costs in advance.

19.6.3 *Summing up*

It is clear from the audit reports we examined that good DBFM(O) evaluations are few. Methodological problems and a lack of willingness to undertake critical evaluations are the main contributory factors. At the same time, the few evaluations that were included in the audits didn't show clear evidence that DBFM(O) projects are more efficient than the traditional forms of procurement.

19.7 Policies and conditions for successful PPPs

Audit offices pinpoint a number of vital requirements that both government policy and government organizations need to meet in order to ensure that PPPs are successful. These are:

- a clear definition of the public interest that is at stake;
- the use of a programme-based approach;
- the use of standardized contracts and manuals;
- the creation of knowledge resource centres.

19.7.1 *A clear definition of the public interest that is at stake in the PPP*

Audit offices attach great value to a clear definition of the public interests that are at stake in the PPP in question (e.g. ISSAI 5220: 18; ISSAI 5240: 8; USA 2008: 9)

Governments in some countries, including Australia and the UK, have developed systematic approaches to identifying and evaluating public interest before agreements are entered into, including the use of public interest criteria, as well as assessment tools, and require their use when considering private investments in public infrastructure. For example, a state government in Australia uses a public interest test to determine how the public interest would be affected in eight specific areas, including whether the views and rights of affected communities have been heard and protected and whether the process is sufficiently transparent.

(USA 2008: 9)

19.7.2 *Programme-based approach*

Audit offices often recommend that government departments and agencies adopt a programme-based approach to PPPs (e.g. Hungary 2009: 3). The UK's National Audit Office claims that:

greater support for public authorities is provided by those departments managing their PPPs as part of a structured programme, such as the Waste Infrastructure Development Programme and the Building Schools for the Future programme. These departments provide an overall aim of the programme, develop the private-sector supply side, evaluate projects and disseminate good practice. Our reports on these programmes have highlighted the benefits that such an approach can bring to a portfolio of projects.

(UK 2009: 60)

However, some audit offices also levelled criticisms at such structured programmes or PPP resource centres. For example, the Netherlands Court of Audit criticized the measurability of the objectives set for the Dutch PPP Knowledge Resource Centre (i.e. no targets and no quality definition; The Netherlands 2000: 14, 19–20). In its report *National Maritime Development Programme*, the Office of the Comptroller and Auditor General of India wrote that PPPs had not yet got off the ground, partly because no clear time schedule for all stages of schemes was formulated and ‘that concerted efforts should be made to implement these schemes in a time-bound manner’ and also that ‘while framing BOT agreements performance benchmarks need to be fixed as per identified best practices’ (India 2010: 86, 93).

19.7.3 Standardized contracts and manuals

In their audit findings and recommendations, the audit offices stress the importance of using standardized contracts and procurement procedures, and of producing guidelines and manuals for these. The UK’s National Audit Office believes that these should offer great advantages in that ‘standardized contracts generally provide a sound basis for the allocation of generic risk in a PFI project’ (UK 2009: 23). ‘Standardisation enables private finance contracts to achieve greater consistency in best practice’ (UK 2009: 29). As the Belgian Court of Audit sees it, standardization leads to lower transaction costs, less complexity and greater transparency (Belgium 2009: 14). The Auditor General of Nova Scotia points to another benefit: ‘a contract management manual, for instance, would provide guidance to current and new staff, helping to ensure there are adequate and consistent contract management processes followed when staff responsibilities change or new staff are hired’ (Canada, Nova Scotia 2010: 37).

Whereas many audit offices (e.g. USA 2009: 38–9; Canada, Nova Scotia 2010: 37; Hungary 2007b: 1; Belgium 2009: 14) found that no manuals on PPPs were available, in those countries in which manuals had been produced, these sometimes displayed shortcomings. For example, the Netherlands Court of Audit found in 2002 that the manual produced by the Ministry of Finance for the financial management of PPP and DBFM(O) projects did not discuss the aspects of integrity of staff (The Netherlands 2002: 77).

19.7.4 Knowledge resource centres

Audit offices found that, as a consequence of the lack of standardization, the transfer of knowledge all too often took place on an *ad-hoc* basis (e.g. Belgium 2009: 14). They emphasized the importance of PPP resource centres and support units (e.g. Lithuania 2008: 4; Canada, Alberta 2007: 38).

cooperation between the public and private sector hides high risks as long as there is [. . .] no organization responsible for the coordination, evaluation and auditing tasks.

(Hungary 2005: 3)

A number of audit offices recommended setting up national knowledge resource centres to support local and regional authorities, as well as individual organisations such as schools (e.g. USA 2009: 38–9). As far as they are concerned, these resource centres and support units do not necessarily need to be public-sector organisations. The US Government Accountability Office points out, for example, that:

some countries have further protected the public interest in transit projects that use alternative approaches by establishing quasi-governmental entities to assist project sponsors in implementing these arrangements. Entities such as Partnerships UK, Partnerships Victoria, and Partnerships BC are often fee-for-service and associated with Treasury Departments on the provincial and national levels.

(USA 2009: 37)

The US Government Accountability Office goes on to say that:

according to officials in the UK and Canada, these entities create a consistent approach to considering public-private partnerships, such as understanding a project's main risks, which can reduce the time and costs incurred when negotiating a contract. Further, by using standardized contracts developed by these entities, project sponsors can reduce transaction costs – such as legal, financial, and administrative fees – of implementing transit projects that use alternative approaches. Moreover, project sponsors and consultants told us that entities like Partnerships UK and Partnerships BC can foster good public-private partnerships and help further protect the public interest by ensuring consistency in contracts and serving as a repository of institutional knowledge.

(USA 2009: 37)

19.7.5 *Summing up*

It is remarkable to read so frequently in audit reports that governments have failed to take basic action such as drafting standardized contracts and producing PPP manuals. Governments would also appear to be bad at institutionalizing their own knowledge. In this sense, a programme-based approach coupled with a clear definition of the nature of the public interest that is or should be addressed by the PPP in question is crucially important. Audit offices stress the importance of standardization as allowing governments to lower the transaction costs and mitigate the lack of expertise and the degree of continuity. The latter is a particular problem for governments as compared with private-sector parties, who are generally able to offer better pay.

19.8 **General conclusions and lessons learned**

A number of summary conclusions may be drawn, and lessons learned, from our analysis of the audit reports. Broadly speaking, we conclude that audit offices are fairly critical with regard to PPPs. As might be expected, audit office reports tend to focus more on those aspects where there is scope for improvement than on things that go well. The main conclusions and lessons regarding PPPs – which also can be read as a list of do's and don'ts – are the following:

19.8.1 *Added value test*

A number of audit offices found that no added value tests had been performed to corroborate the financial and economic benefits ascribed to PPP projects. At the same time, various audit reports pointed out that, even where such tests were used, certain limitations were inherent to them and their use by decision-makers. The same applies to the conclusions drawn on the basis of the results of added value tests: there is often insufficient evidence to support such conclusions. The claims made about the efficiency gains generated by PPPs on the basis of the outcome of these tests are debatable at the very least.

19.8.2 Procurement

The procurement procedures on which PPP contracts are based is a recurring topic in audit reports. According to the audit offices in question, the tender procedures followed are generally – albeit not always – adequate, with problems arising for example where insufficient account is taken of market conditions or where not enough competitive bids are received. One problem frequently identified by audit offices is the absence of sufficient internal and external controls. These controls would sometimes appear to conflict with the need for preserving the confidentiality of sensitive business information in relation to the projects in question.

19.8.3 Financing and costs

Apart from one or two exceptions, the findings of audits of the financing and costs of PPP projects are all very critical: cost calculations are not complete, alternatives are not compared on a comparable basis, and the government still bears a disproportionate degree of the risk and hence ends up footing too much of the bill. The incentive to keep the cost of the project off the balance sheet may result not only in the added value test being biased towards a PPP approach, but also in the terms of PPP contracts being less than ideal.

19.8.4 Contract management

Many audit offices also found shortcomings in both the planning and execution of contract management, pointing in this connection to the difficulty of formulating good performance indicators. In some cases, contracts do not contain effective monitoring clauses. In other cases, even where there is a well-designed system of performance management, the monitoring activities and internal controls do not actually work properly in practice. The fact that government officials do not possess the necessary expertise is a problem in this respect. Audit offices also found that amendments made to contracts after they have been signed tend to jeopardize their added value.

19.8.5 Political accountability

Broadly speaking, we found that most audit reports did not look at the way in which parliament is kept informed, nor at the opportunities open to parliament for influencing the terms of PPP contracts. In addition to reporting to parliament on specific projects and submitting progress reports on policy, there is also scope for using routine budgetary and reporting procedures to inform parliament about PPPs. This is a point about which audit offices that looked into the information of parliament are very critical: a great deal of financial information remains outside the regular budgetary and reporting procedures.

19.8.6 Evaluations

Good DBFM(O) evaluations are few and far between. In part, this is due to methodological problems and a lack of willingness to undertake critical evaluations. This is a missed opportunity for the public sector to learn from past mistakes. At the same time, we also found that the value for money and added value of PPP projects are aspects that can be computed only in the long term, on the basis of the whole life of the contract in question, which often extends to a period of over 30 years. Hardly any PPP projects have reached this point yet.

19.8.7 Organization and prerequisites

A number of audit offices argue in favour of a policy on PPP and the adoption of a programme-based approach to PPP projects. These are often absent. A PPP policy should include a clear definition of the nature of the public interest that is at stake in the projects in question, as well as a thorough analysis of the added value of using a PPP as compared with a public-sector alternative. This policy should be underpinned by facilities for collecting and sharing knowledge and experience in the form of knowledge resource centres, and by the development of standardized contracts and manuals. In those cases where governments have formulated a policy on PPPs, it is not always fully adopted in practice.

To sum up, huge public interests are often at stake in PPP projects, in terms of the nature and quality of the public services and facilities delivered by them, and the amount of public money invested in them. Audit offices can have an important contribution in this field, not only by issuing audit reports on the subject but also by publishing best practices and guidelines for (the audit of) PPP projects.² Public accountability is a key aspect of PPP projects, and improving accountability can help to improve both the decision-making on these projects and the value for money they generate.

Notes

* This chapter does not necessarily reflect the opinion of the Netherlands Court of Audit.

- 1 The worldwide association of national audit offices, INTOSAI, has 188 members in 193 officially existing countries. National audit offices are relatively new phenomena in some countries, such as the new democracies in Africa and Eastern Europe. In many other countries, however, they have been around for many centuries.
- 2 The UK's National Audit Office is a particularly keen exponent of this. INTOSAI, the international organization of supreme audit institutions published several guidelines for the audit of PPP's (ISSAI 5220, 5240). The Office of the Comptroller and Auditor General of India has also formulated guidelines for auditing PPP projects (e.g. India 2009).

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