

**PUBLIC-PRIVATE PARTNERSHIPS: INTERNATIONAL and NATIONAL  
AUDIT FINDINGS OF THE NETHERLANDS COURT OF AUDIT**

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## 1. Introduction

In this paper we discuss in the first part the audit findings on PPP's by various national (or 'supreme' audit institutions', as they are also called) and regional audit offices<sup>1</sup>.

In the second part we go deeper into a recent (2013) audit of the Netherlands Court of Audit on two specific aspects of a PPP: the PPP contract management and the information supplied to the House of Representatives (Netherlands Court of Audit, '*Contract management in DBFMO*', The Hague, 2013).<sup>2</sup>

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. With this paper we want to share the findings of the Netherlands Court of Audit with a broader academic audience.

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

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<sup>1</sup>The first part of this paper is a summary of the book chapter '*Public-private partnerships: international audit findings*', in P. De Vries and E.B. Yehoue (eds.), *The Routledge Companion to public-private partnerships* (Routledge, Abingdon, 2013, chapter 19). This book chapter was written by *Ineke Boers, Freek Hoek, Cor van Montfort and Jan Wieles*. At the time of writing they all worked at the Netherlands Court of Audit.

For a copy of (the last draft of) the full text of the book chapter please send an email to [c.vanmontfort@rekenkamer.nl](mailto:c.vanmontfort@rekenkamer.nl).

<sup>2</sup>The full text of the report '*Contract management in DBFMO*' (Netherlands Court of Audit, The Hague, 2013) can be found on: [http://www.courtofaudit.nl/english/Publications/Audits/Introductions/2013/06/Contract\\_management\\_of\\_DBFMO\\_projects](http://www.courtofaudit.nl/english/Publications/Audits/Introductions/2013/06/Contract_management_of_DBFMO_projects)

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).

## **PART 1**

### **International comparison of audit findings in PPP audits by supreme audit institutions.**

#### **2. Scope of the study**

The first part of this paper is based on a study of audit office reports on PPPs that we carried out in 2010 and that was published in 2013 (see footnote 1). 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.

#### **3. Findings**

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.

This part of our paper 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 first part of the paper ends with a number of concluding remarks on PPP and comments on the role played by audit offices in this connection.

### **3.1. The pre-contract stage**

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.

### **3.2. Financing and costs**

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.

### **3.3. Contract management**

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.

### **3.4. Political accountability**

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.

### **3.5. The evaluation of PPP projects**

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.

### **3.6. Policies and conditions for successful PPPs**

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.

#### **4. General conclusions and lessons learned**

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't's -are the following:

##### *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.

##### *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.

#### *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.

#### *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.

### *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.

### *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.

### *Organisation 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.<sup>3</sup> 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.

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<sup>3</sup> 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).

## **PART 2**

### **Audit findings of the Netherlands Court of Audit on contract management in relation to DBFMO projects**

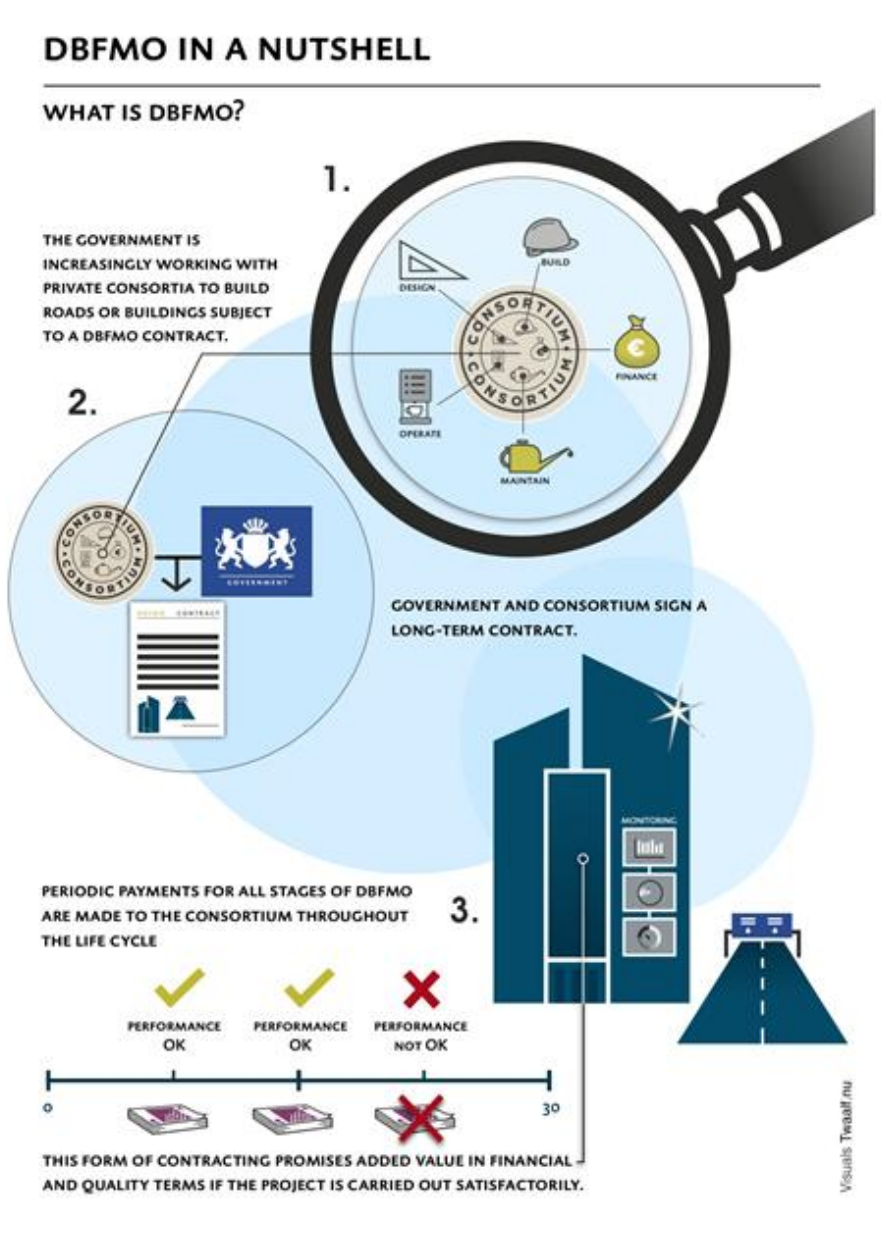
#### **5. Why an audit on contractmanagement in relation to DBFMO projects?**

International SAI audits, as described in part one, have found that good contract management is decisive to retain both the financial and the qualitative added value of a DBFMO project throughout the term of the contract. The risks highlighted internationally, the increase in the number of projects, their substantial financial importance prompted the Netherlands Court of Audit to carry out an audit of DBFMO projects in the Netherlands. The audit focused on contract management and on the information supplied to the House of Representatives considers central government's management of DBFMO contracts.

The abbreviation DBFMO stands for the various stages in a project: Design, Build, Finance, Maintain and Operate. A DBFMO contract covers all stages of a project by means of a single contract concluded with a single procuring authority.

A DBFMO contract includes mechanisms to balance the interests of the private party with those of the public party. The main mechanism is the control mechanism that links the consortium's performance to the payment made by the government. The government makes the payment only when the agreed performance has been delivered. The delivery

of the performance is determined by means of a monitoring system designed by the private party (see infographic below).



In the Netherlands DBFMO contracts are a relatively new form of public private partnership. Our Minister of Finance has been encouraging the use of DBFMO since 1998. At the end of 2012, 13 DBFMO projects were being carried out: six infrastructure projects and seven building projects (Ministry of Finance, 2012). The total value of the

contracts exceeded €6 billion and the projects' estimated financial added value was €800 million. About 20 projects are currently in the tendering or decision-making stage. This audit examined five DBFMO projects with a total contract value of €1.5 billion and an estimated added value of €265 million.

## **6. Audit Objective and Approach**

The audit objective was to gain an understanding of the use of DBFMO in practice and specifically of the performance of contract management. The key audit question was whether the government steered and controlled the implementation of DBFMO projects so as to safeguard the public interests effectively. We also examined whether the House of Representatives was adequately informed of the financial and other consequences of DBFMO projects. DBFMO contract management has never previously been audited in the Netherlands. We did not make comparisons between DBFMO and more traditional forms of contracting in this report.

## **7. What did we find: results and conclusions**

We drew the following conclusions from our audit of the implementation of DBFMO projects:

1. Better contract management in relation to DBFMO projects is needed to safeguard the public interest and secure added financial value.
2. In order to assess the pros and cons of DBFMO, the House of Representatives needs information on the performance of DBFMO contracts.

### *7.1. Contract management in DBFMO*

Strong contract management is an important mechanism to balance the interests of the government with those of the private contractor and to realise the financial added value

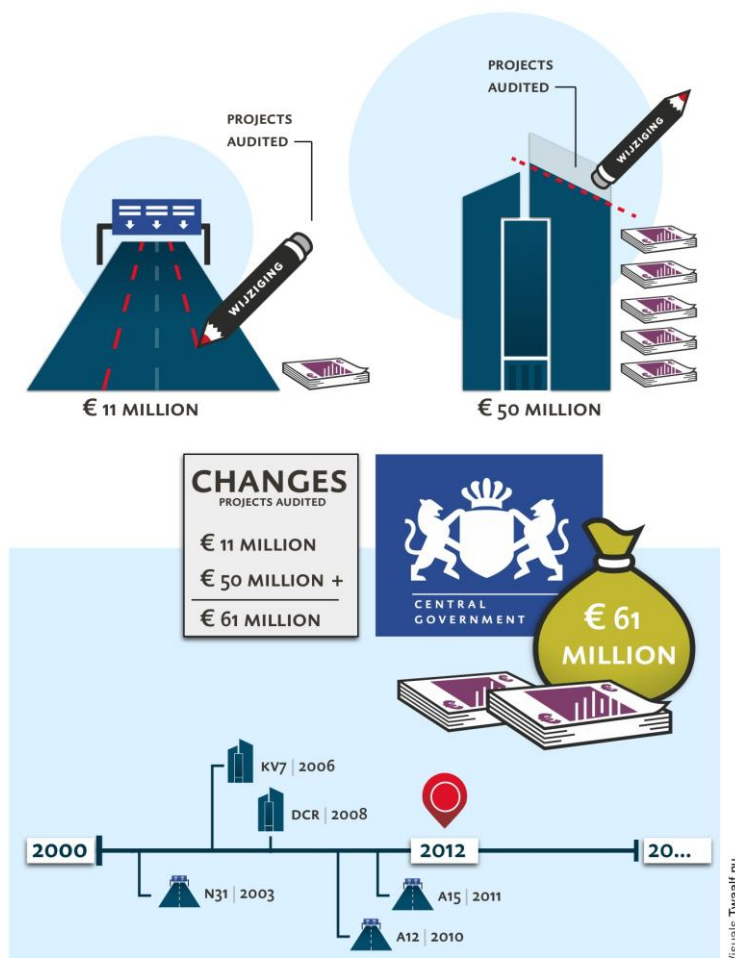
of DBFMO contracts if changes are made during the contract term. We audited how the “payment by result” principle of DBFMO had been applied and how contract changes had been dealt with on five projects. The total contract value of the five projects audited was €1.5 billion and the estimated added value was €265 million.

We researched the DBFMO principle of “payment by agreed performance”. If the consortium does not deliver the agreed performance in full or in part, the government will not pay the full availability fee. This mechanism gives equal importance to the interests of the government and those of the private consortium.

In practice, the contractual payment mechanism in the five projects we audited was clear. The government linked the greater part of the payments it made to the performance delivered. However, we also found a number of problems: (1) the government does not always impose penalties or deductions, (2) the consortia's performance was not optimally monitored, and (3) the government makes guaranteed payments. These findings are inconsistent with the DBFMO principle and therefore compromise the relationship between the cost and the quality of a project (Further details on the management mechanism and its operation, AR 2013).

Contract variations are likely to be inevitable due to the long-term nature of the contracts. DBFMO principles should still apply to contract variations. Cost transparency should discourage variations. If a change is requested, the contracting parties draft a change contract

In practice, we saw that the government had requested major and minor changes in the projects we audited. Major changes were necessary because the design, in hindsight, did not suit the primary process, because the user requirements of a building had changed or because new government regulations were applicable. Changes in DBFMO contracts increase the project cost. Changes are a cause of discussion between the government and the private consortium. In the five projects we audited, the government had concluded 157 change contracts with financial consequences. The government entered into new financial commitments in the change contracts totalling €61 million. Of this amount, €50 million related to buildings. Building facility services (the 'O' in the contract) are particularly sensitive to change.





The cost of changes is not included in the original project budget and is added to the contractually agreed availability fee. As a result, the overall project cost is higher than budgeted. The transparency of the cost of a change should encourage discipline: sufficient information should be provided to enable the government to weigh up the financial consequences against the need for a change. In practice, however, such discipline is difficult to exercise, especially in the case of buildings, because user requirements often differ from the contractual agreements. At issue, however, is whether the changes represent value for money. Changes are made in all types of contract and some would probably have been made in a traditional contract. It therefore cannot be said that the estimated added value declined by €61 million. The costs of changes in two of the contracts concluded by the Government Buildings Agency (€50 million) were considerably higher than the financial added value calculated for them (€30 million). The need to recalculate the added value would seem self-evident. To recalculate the financial added value correctly, proper records must be kept for the project and necessary data should still be available.

#### *7.2. Provision of information to the House of Representatives*

The House of Representatives receives information on DBFMO contracts chiefly in respect of compliance with the applicable policy rules on the thresholds set for the assessment of added value. Biennial progress reports provide information on how line ministries implement policy, the results of the added value test of prospective projects and on which projects are being carried out. This information, however, provides only

limited insight into DBFMO projects because the House receives no information on the implementation of projects after the contract has been closed. The House also receives no information on the financial cost of changes or on income from penalties or deductions.

The most striking figure in the information received by the House is the €800 million that the Minister of Finance described as actual added value (Ministry of Finance, 2012). This €800 million is based on an added value test that was used as an aid during the tendering stage. We wonder how reliable this figure is and question its disclosure and realisation (see also Netherlands Court of Audit, 2002). It was produced by mathematical models that (inevitably) work with assumptions and uncertainties. The disclosed added value of €800 million should therefore not be seen as actual added value but only as an estimate.

Further the House of Representatives has only limited insight into the longer-term budgetary flexibility of DBFMO. The customary budgeting and accounting methods are not suited to the specific nature of DBFMO. The financial commitments of a DBFMO contract continue for far longer than the five-year budgeting and accounting cycle. The long-term commitments for DBFMO contracts therefore cannot be seen in the State balance sheet and are disclosed only partially in the government's accounts. More information is available on the commitments for infrastructure projects, carried out in the MIRT multiyear spatial planning and transport infrastructure programme, than for government buildings. The proportion of DBFMO projects to the total project portfolio (non-DBFMO) is also uncertain. Finally, the current DBFMO projects are not yet included in the EMU balance. They must be as from 2014.

## **8. Conclusion**

The international comparison in part 1 showed that many audit offices found shortcomings in both the planning and execution of contract management. One of the findings concerned the fact that amendments made to contracts after they have been signed tend to jeopardize their added value.

Another finding of the international study was that a great deal of financial information on PPP project to the parliament remains outside the regular budgetary and reporting procedures.

These findings were based on audit reports of Supreme Audit Institutions until 2010. In our recent audit from 2013 of contract management in DBFMO contract in the Netherlands we came to comparable but also to slightly different conclusions.

We concluded that, due to the cost of changes in the contract the overall project costs are higher than budgeted. But this can happen in traditional contracts too, so if we want to draw conclusions on the effect of project changes on the added value, we should compare with traditional contracts and reliable data should be available.

The House of Representatives in The Netherlands receives information on DBFMO contracts, but this information provides only limited insight into DBFMO projects because the House receives no information on the implementation of projects after the contract has been closed. The House also receives no information on the financial cost of changes or on income from penalties or deductions.

Further the long-term commitments for DBFMO contracts therefore cannot be seen in the State balance sheet and are disclosed only partially in the government's accounts. This corresponds with the findings of the international comparison of PPP audits by Supreme Audit Institutions.

Both studies show, among other things, that with regard to contract management and information provision to the parliament major improvements are still possible.