AUDIT OF
Public Private Partnership (PPP)
MODEL

Introduction

- Public Private Partnerships offer a unique and innovative method of involving the private sector in the nation building activity and in accelerating the delivery of public goods and services of high quality through joint enterprises, without spreading the limited available resources too thin.
- In order to sustain the high annual growth rate, Public Private Partnership (PPP) will be an attractive option in meeting this challenge.

What are Public Private Partnerships?

United Nations defines public private partnerships as

- "*innovative methods used by the public sector to contract with the private sector who bring their capital and their ability to deliver projects on time and to budget, while the public sector retains the responsibility to provide these services to the public in a way that benefits the public and delivers economic development and improvement in the quality of life*".
- Aim at financing, designing, implementing and operating public sector facilities and services.

What Are the Types of PPPs?

- Broadly, PPPs could be categorized into *Institutionalized PPPs* and *Contractual PPPs*.
- Institutional PPPs are usually a joint venture (JV) between public and private sector stakeholders to carry out PPP projects by sharing the risks and to provide public services on a long term basis. The Noida Toll Bridge Company (NTBC) and the Bangalore International Airport Limited (BIAL) are examples of this kind.
- Contractual PPPs fall under the concession model, in which case a facility is given by the public sector unit concerned to a private sector partner which usually designs, constructs and operates the PPP project for a given period of time.

MODELS OF PPP

- Build, Operate and Transfer (BOT)
- Lease, Operate and Transfer (LOT)
- Build Own, Operate (BOO)
- Build, Own, Operate and Transfer (BOOT)
- Design, Build, Finance and Operate (DBFO)
- Design, Build, Finance, Operate and Maintain (DBFOM)
- Operations Concession
- Joint Ventures

PPP models

Build, Operate and Transfer (BOT)	Under this category, the private partner is responsible to design, build, operate (during the contracted period) and transfer back the facility to the public sector. The private sector partner is expected to bring the finance for the project and take the responsibility to construct and maintain it. The public sector will either pay a rent for using the facility or allow it to collect revenue from the users. The national highway projects contracted out by NHAI under PPP mode is an example.

Lease, Operate and Transfer (LOT)	As the name indicates, under this type of PPPs, a facility which already exists and is under operation, is entrusted to the private sector partner for efficient operation, subject to the terms and conditions decided by mutual agreement. The contract will be for a given but sufficiently long period and the asset will be transferred back to the government at the end of the contract. Leasing a school building or a hospital to the private sector along with the staff and all facilities by entrusting the management and control, subject to pre-determined conditions could come under this category.

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Build Own, Operate (BOO) or Build, Own, Operate and Transfer (BOOT)	This is a variation of the BOT model, except that the ownership of the newly built facility will rest with the private party during the period of contract. This will result in the transfer of most of the risks related to planning, design, construction and operation of the project to the private partner. The public sector partner will however contract to 'purchase' the goods and services produced by the project on mutually agreed terms and conditions. In the latter case (BOOT), however, the facility / project built under PPP will be transferred back to the government department or agency at the end of the contract period, generally at the residual value and after the private partner recovers its investment and reasonable return agreed to as per the contract.

Design, Build, Finance and Operate (DBFO) or Design, Build, Finance, Operate and Maintain (DBFOM)	These are other variations of PPP and as the nomenclatures highlight, the private party assumes the entire responsibility for the design, construct, finance, and operate or operate and maintain the project for the period of concession. These are also referred to as "Concessions". The private participant to the project will recover its investment and return on investments (ROI) through the concessions granted or through annuity payments etc. It may be noted that most of the project risks related to the design, financing and construction would stand transferred to the private partner. The public sector may provide guarantees to financing agencies, help with the acquisition of land and assist to obtain statutory and environmental clearances and approvals and also assure a reasonable return as per established norms or industry practice etc., throughout the period of concession.

Operations Concession	This is a generic term, used to clarify the essential features of PPP arrangements. The PPP agreements which authorize the private partner to recover its investments and expected returns on investments through concessions granted for a certain period, computed on the basis of demand projections and growth, are called operations concession (OC). In these cases, the public sector (department or agency) which is responsible to provide the service to the public and collect revenue by way of user charges, toll, tariff etc., assigns its legal or statutory right to the private partner in return for the latter undertaking the responsibility to implement the project and maintain the required quality. The concession may be by collecting tolls and user charges or by the public sector making periodical payments of annuities or monthly / quarterly/ half-yearly charges on certain assumed basis, like shadow tolls etc.

Joint Ventures	In a PPP arrangement commonly followed in our country (such as for airport development), the private sector body is encouraged to form a joint venture company (JVC) along with the participating public sector agency with the latter holding only minority shares. The private sector body will be responsible for the design, construction and management of the operations targeted for the PPP and will also bring in most of the investment requirements. The public sector partner's contribution will be by way of fixed assets at a pre-determined value, whether it is land, buildings or facilities and /or it may contribute to the shareholding capital. It may also provide assurances and guarantees required by the private partner to raise funds and to ensure smooth construction and operation. The public service for which the joint venture is established will be provided by the entity on certain pre-set conditions and subject to the required quality parameters and specifications. Examples are international airports (Hyderabad and Bangalore), ports etc.

Objectives of Public Private Partnership

- Encourage private sector involvement in public infrastructure and related services where value for money for the government could be clearly demonstrated.
- Encourage innovation in the provision of infrastructure and related service delivery.
- Encourage rigorous governance over the selection of projects and competition for the award of contracts.
- Clearly articulate accountability for outcomes.

REQUIREMENT OF PPP PROJECTS

Private sector participation in PPP projects requires a framework that can enable the private sector to

- secure a reasonable return at manageable risk,
- assure the user of adequate service quality at an affordable cost,
- facilitate the Government in procuring value for public money.

These conditions are more difficult to fulfill than is commonly realized. Because of

- Multiple stakeholders pursuing conflicting interests,
- Risk mitigation arrangements are usually complex.
- Inadequate preparatory work in relation to the framework for PPP projects,
- Identification of projects,
- Selection of private participants,
- Preparation of strategic plan and project reports,
- Drafting of contracts and other associated activities require excessive transaction costs,
- Years of delay in project implementation,
- Inadequate quality,
- large contingent liabilities to the Government.

Objectives of the PPP Audit

- The basic objective of public audit is to ‘provide unbiased, objective assessment of whether public resources are responsibly and effectively managed to achieve the intended results.
- Auditors, through their evaluation, (should) help the government organizations achieve accountability and integrity, improve operations, and instill confidence among citizens and stakeholders.
- Public auditors’ role supports the governance responsibilities of oversight, insight, and foresight.
- Oversight addresses whether government entities are doing what they are supposed to do and serves to detect and deter public corruption.
- Insight assists decision makers by providing an independent assessment of government programmes, policies, operations and results.
- Foresight identifies trends and emerging challenges

- The audit of PPP projects differ from the conventional audit of public entities in several ways.
- For instance, the very concept of PPP arrangements assumes and accepts, *ab initio*, the conflicting and fundamentally differing approaches of the two partners to the arrangement, namely the responsibility of the public sector partner to provide goods and services to the public at reasonable costs against the motive of the business partners to maximize profits .
- The former holds the authority and regulatory skill as against the management and technical skills of the latter.
- Even within the private sector partner different participating members may have divergent and conflicting objectives. For example the sponsors /financiers may be interested in fixed cost construction contacts whereas the latter may prefer greater flexibility in this regard.
- While vendors may like to maximize revenue the financiers / construction contractors may want to minimize such costs.
- The public auditor must remember this and appreciate that inspite of seemingly conflicting objectives the PPP is a fusion of the diverging talents and skills and that the common objective of the partnership must be to improve the value for money by combining the capabilities of both.

- Delivery the expected public facility within the desired cost, timeframe and specifications is the surest guarantee that all the involved parties stand to gain. 'The PPP policy provides a consistent framework that enables the public and the private sectors to work together to improve public services delivery through private sector provision of public infrastructure and selected services. Value for money is the driver for adopting the PPP approach rather than capital scarcity or balance sheet requirements' It must also be remembered that the audit should focus sufficiently well on the achievement of the contracted end products; it should not stand in the way of innovations injected into the partnerships which is one of the keys to the success of the enterprise.

- The main objective of the audit of PPP projects is to provide a reasonable assurance to all stakeholders about the wisdom, faithfulness, integrity, economy, efficiency and effectiveness of the PPP arrangement and to ensure that the infusion of the private sector agency into the project has resulted in improving the value for money for the government.
- The aim is to cover all aspects of the project contracting and execution, but without impacting the freedom and innovations built into the arrangement.
- Further, unlike in the case of audit of government departments and entities, the relevance of regularity and compliance audit will be limited since the focus of PPP audit will be on contract audit, validity of total project cost, economy and efficiency of operations of the entity as seen from the public participant’s point of view and most of all on achieving the objectives (results) of the partnership rather than on how the private sector partner secures goods and services for the project.
- These subtle points have to be borne in mind while planning and conducting the PPP audit.

- A question uppermost in the mind of public auditors when they plan the audit of PPPs would be the type of documents to be subjected for the scrutiny. Since the majority stakeholder in terms of financing, construction, operation and maintenance of the project would be the private sector partner, (and since these and associated risks would stand transferred to it), the question will have significant relevance. This is also closely related to the issue of “audit evidence”, which refers to data, information and documents relied upon to arrive at audit findings and conclusions

Public auditors should subject the following data and documents relating to the project for scrutiny

i) *Documents regarding the project formulation, appraisal and approval, available with the nodal ministry, promoting agency.*

- The most important checks to be exercised in a PPP project will include the scrutiny of the initial records in the government agency concerned so as to ensure that the decision to adapt the PPP route was fair and reasonable and was taken after considering all alternatives.
- The feasibility of the project including demand assessments and projections, the comparative benefit of executing the project departmentally or outright contracting (wherever relevant feasible), detailed specifications arising from the Detailed Project Report, total project cost and operating costs, financing alternatives, financial analysis of funding options, appraisal of the project proposal by empowered ministries, method of determining the concession and viability gap funding, if any, payment of annuity or revenue sharing arrangements etc. would be crucial for audit scrutiny.

(ii) Data and documents relating to the contract documents and concession award originated by and available with the public sector partner.

These include all documents relating to the tendering procedures, award of tenders, tender conditions and processes, engagement of Independent Engineers and Auditors to oversee the construction and operation management, asset transfers, valuation of assets and all related information, which would provide adequate information regarding the execution of the project.

iii) Data and documents furnished to the public sector partner by the private contractor and available with the former for verification.

The third type of documents required to be scrutinized will be those generated by the private sector partner and submitted to the public sector partner, usually as mandated in the contracts. These will be the documents related to the financial closure, design and construction details, specifications and variations, if any, and requests for completion of pre- requisites (condition precedents) to undertake the work. Another important set of documents to be checked would be the returns relating to the volume of demand / traffic generation against projections, revenue realization, escrow account details, and periodical accounts statements etc. required to be furnished by the operating partner, after completion of the project.

iv) Reports submitted by the Independent Engineers and Independent Auditors

- These documents will give a clear insight into the construction, operation and maintenance and the commercial aspects thereof of the project. Public auditors should verify them carefully to ascertain the compliance by the private sector partner with specified norms and specifications relating to the execution of the contracts.

- All documents referred to at sl.no. (i) & (ii) will be readily available with the concerned Government department / public authority. As mentioned above documents referred to at sl.no. (iii) & (iv) can also be substantially accessed through the Government entity.

Accessing the Documents and Records of the Private Partner by Auditors

- A question which requires to be addressed in this regard is whether the auditors are required to access the documents of the private partner for the purpose of their audit. It could be assumed that the private sector partners are likely to resist the move on the plea of commercial confidentiality.

- In the normal course, all documents and data required by the public auditors are likely to be available with the government department and the public sector agency which promoted the PPP project. However, in case any additional information is essential for the purpose of verifying facts and for audit evidence, the public auditors may take recourse to Paragraph 169 of the CAG's Regulations on Audit and Accounts 2007

MANDATE OF AUDIT AND ACCESSIBILTY TO RECORDS

- Public Private Partnerships may be formed by different government agencies and bodies usually to promote and develop infrastructure facilities by inviting private sector participation. Some examples are given below:
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a) Government departments directly or in conjunction with a PSU, investing resources in a PPP project and authorizing the private sector partner / JVC to build the project and to provide public services on cost recovery basis while holding only minority shares in the joint ventures formed for the purpose;

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- b)Public sector undertakings (PSUs) contracting with private entrepreneurs for development of infrastructure facilities by providing concessions / annuity and / or viability gap funding;

c) Autonomous bodies substantially funded by the Government joining hands with private sector entities to develop infrastructure projects, with the former investing in (the assets of) the project.

d) Any other combination of the above which has significant investments of a public agency and shifts the responsibility to provide public services to a private entity in the PPP mode

- Under the Comptroller & Auditor General's (DPC) Act, 1971, and as incorporated in the Regulations of Audit and Accounts (2007), the audit mandate of the CAG of India will extend to all types of (promoting) public institutions, namely, government departments (as the sole auditor of the accounts of the Union and States), PSUs (in terms of the Companies Act), and to bodies and authorities etc. (as provided under the DPC Act). The DPC Act however does not directly contemplate the audit of PPP projects or joint ventures with only minority participation by the government agency since these are recent innovations under the development strategy

- Under the circumstances, the public auditor shall have to confine his audit to the data, records and documents in the possession of the government department, PSU or autonomous body which is the public sector partner of the PPP arrangement, and rely on it for additional information, as is required to fulfill his tasks.

International Auditing Standards and Guidelines for the Audit of PPP Projects

- The need to examine the status of internal controls in the public bodies that enter into PPPs so as to provide a reasonable confidence that public resources would be protected and institutional objectives would be met.
- Verification of the strategic plan setting out the objectives for the PPP and the possible alternatives to balance conflicting priorities.
- Whether advisers were appointed after adequate scrutiny and evaluation and objectively, and whether their compensation is linked to performance.
- Use of a portfolio of performance measures to evaluate the partnership, both financial and qualitative, including customer satisfaction levels, cash flow pattern, and other norms.

- The need to carry out audit tests to evaluate systems and procedures and management of performance indicators.
- Whether a range of vehicles have been considered and a structure which best suits the public interests has been selected after reviewing the actual cash flow and sustainability through adequate Return on Investment (ROI).
- Whether third party reviews were undertaken before finalizing the partnerships, whether cost benefit analysis was carried out carefully, and contractual payments, if any, linked to milestones.
- System to receive regular information and returns on partner's performance and obligations.
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Basically, the INTOSAI guidelines list out the key risks facing the Governments and the SAIs in developing / auditing PPP projects, and these include:

State's Risks

- Lack of clarity about partnership objectives;
- Inadequate definition of business model of the partnership
- Risks associated with negotiating an appropriate partnership;
- Risks to the State's interests as a minority shareholder;
- Risk associated with monitoring of the State's interests in the partnerships, and;
- State's exposure in the event of difficulties

- **Supreme Audit Institutions’ Risks**

- SAI’s risks would include;
- Insufficient domain knowledge
- Lack of expertise required to examine the process and the results;
- Failure to identifying worthwhile lessons, and;
- Absence of following up the audit work

Auditing Process and Criteria for PPP Audit

- (1) Process flow of Public Private Partnership Arrangements
- (2) Audit Methodology
- (3) Audit of Public Private Partnership Projects:
- (4) Audit of Concessions and Concession Period
- (5) Audit of Risk Allocation
- (6) Audit of Financing Risks
- (7) Audit of Viability Gap Funding (VGF)
- (8) Audit of Tariff / Toll / User charges

(9) Audit of Total Project Cost

(10) Audit of Bidding and Evaluation

(11) Audit of Construction of the Project

(12) Audit of Monitoring of the Project Construction Activities

(13) Audit of Commercial Development

(14) Audit of Operation, Maintenance & Development and the Collection of Revenue

(15) Auditing Public Private Partnerships for Value for Money Evaluation

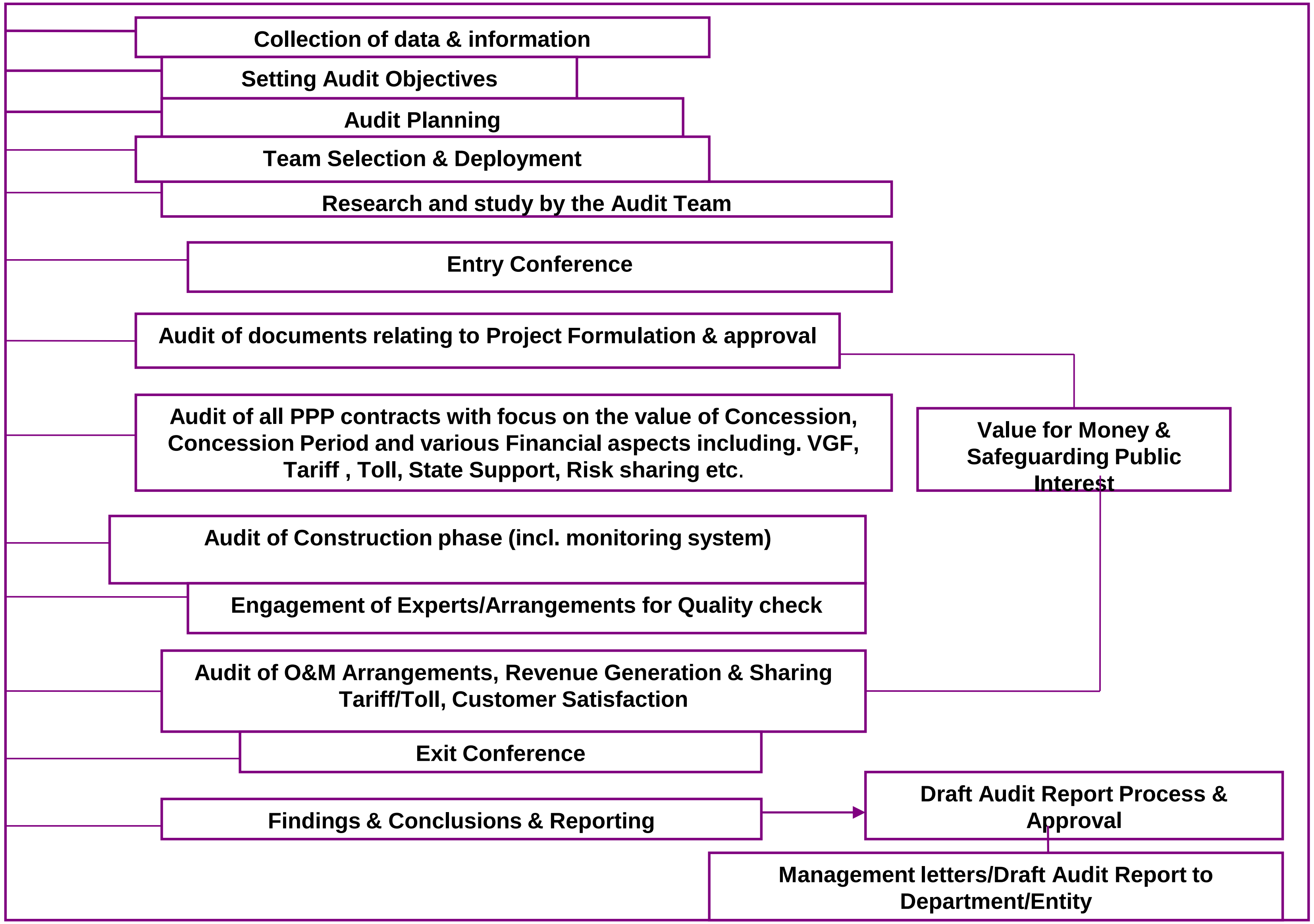
(16) Audit of Valuation of Assets

Auditing Process and Criteria for PPP Audit

(1) Process flow of Public Private Partnership Arrangements

It is essential for public auditors to have a clear idea of the various stages through which a PPP project goes through

A chart indicating the process of the audit of PPP projects



(2) Audit Methodology

Audit of PPP projects requires a combination of skills and expertise; the audit methodology has also to be innovative.

(3) Audit of Public Private Partnership Projects:

A logical approach to PPP audit would be to cover the various aspects of the partnership arrangement sequentially as they occur in actual practice. . In this regard, the first stage will be to analyze the project formulation and approval process. In the following paragraphs, detailed criteria / checklists for the audit of each important stage of PPP projects have been provided.

(4) Audit of Concessions and Concession Period

One of the most important considerations during the audit of PPP projects is the review of the concession granted to the concessionaire in terms of the *quantum and the period* of the concession. Concession amounts to the delegation and transfer of the governmental authority for recovery of user charges / tariff to the private participant possibly under monopolistic conditions, with sharing of risks and contingent liabilities by the public sector participant.

(5) Audit of Risk Allocation

A major characteristic of the PPP arrangement is the balanced and fair allocation of risks between the partners. The underlying principle of risk allocation is that they are allocated to the parties that are best suited to manage them

(6) Audit of Financing Risks

An important aspect to be verified during the audit is the transfer of financial risk. Public auditors must assess whether the entire risk was transferred to the private participant, and what was retained by the public sector partner

(7) Audit of Viability Gap Funding (VGF)

- Grants may be payable for the project either as viability gap funding (VGF) or as annuity during the construction and / or operation of the project. It is essential for the auditors to assess carefully the actual funding gap by analyzing the total capital cost, revenue generation based on projected demand, tariff / toll structure and capping (if imposed), rate of return and cash flow. The DPR will include the working of the total capital cost and the extent of shortage in financing the capital which may not be covered by the expected returns.
- The Central / State Governments provide viability gap funding up to 40 percent of the project cost in deserving cases. Under the “Financial Support to Public Private Partnerships in Infrastructure” (FSPPPI) scheme, infrastructure projects which are economically justified, but fall short of financial viability due to long gestation period, inability to raise the user charges to commercial levels etc. are granted financial support of up to 20% of the capital costs. Additionally, the sponsoring ministry or the State Government concerned could give grants of up to another 20% of the total capital cost. These are however subject to the condition that the private participant is selected on the basis of competitive bidding and would hold at least 51% of the shareholding of the PPP unit. Further, the project agreements to be signed must adhere to the “best practices” that would secure “value for public money” and safeguard user interests.

(8) Audit of Tariff / Toll / User charges

- The user charges for the facility created under the PPP arrangement may be subject to regulations by independent authorities or may be notified under the relevant statute by the state authorities concerned.
- For instance, the toll charges to be levied for a national highway may be notified by the Ministry of Road Transport & Highways or the port charges may be fixed by the Tariff Authority for Major Ports (TAMP). In the case of electricity, the State Electricity Regulatory Commission (SERC) is the empowered agency to fix the tariff.
- These features leave an element of uncertainty regarding the tariff or user charges to be levied in the future for the infrastructure facilities to be created under the PPP projects; whereas the Concession Agreements usually provide for the rate of return on investments on the basis of certain norms of tariff or formulae.
- Auditors have to carefully look for any possible ambiguities and pitfalls in the fixation of tariffs and user charges which could be recovered by the private partners as per the terms of the contracts and for this purpose, they should undertake close scrutiny of the contract conditions.

Audit of regulatory issues in a PPP project will be conducted in accordance with ‘Guidelines on Performance Audit of Regulatory Bodies’. However, the following audit points may be kept in view in the audit of tariff / user charges:

- What is the formula provided in the Concession Agreement to determine the tariff / fees / user charges? Is it reasonable and in line with the industry practice?
- Who is authorized under the Agreement to determine and levy the user charge / fees / tariff? Also, is there a cap on the user charge / tariff to be levied by the private partner?
- Are the user charge / tariff / toll (provided in the Agreement) subject to regulations by an independent authority? Will there be significant impact on the user charge / tariff provided in the Agreement in case the independent authority fixes the tariff common to (and applicable to) all providers of similar service? Does the agreement take into account such eventualities?

(9) Audit of Total Project Cost

- Total Project Cost (TPC) is a critical input and TPC determines the cost of construction, operation and management of the project, debt-equity mix, influences the user charge, viability of the project, financing pattern, financial rate of return (FRR) and economic rate of return (ERR).
- TPC could also be adversely impacted by concessionaire's risk perceptions in terms of attitude of the government authorities and degree of absolutism in the terms and conditions incorporated in the bid documents as to those aspects which can be precisely predicted and measured upfront.
- It is therefore very important for the public auditors to closely examine the TPC to see that it includes only essential items, its composition conforms to accepted accounting standards, and is not 'padded up'. Usually, the technical consultants for the project would have arrived at the TPC, which would be included in the DPR
- The partners to the project are expected to have carried out their due diligence to ensure the accuracy and correctness of the TPC, but the private participants may have some inclination to over-engineer the project, partly due to their apprehensions of safety and security requirements of the project.
- Moreover, since the ROI from the project and the user charge / tariff / toll will depend on the quantum of the TPC, a higher cost of construction might benefit the private partner at the cost of the user community.

- Since one of the compelling reasons for adopting the PPP route is the superior technical and management skills of the private sector, this should be demonstrated by it through innovative approaches and tight control of the TPC (and operational costs). Public auditors are well-versant with the audit criteria to analyze capital expenditures and have sufficient expertise to review TPC. In order to help them in this task, however, some guidelines are given below.
- Does the Agreement provide for verification of TPC by the public sector partner on its own or through its representatives? Has it satisfied itself of the accuracy and correctness of the TPC on its own or through the Independent Engineer / Auditor?
- What is the definition of the TPC in the Agreement? What are the components of the TPC included in the financial package? Are they clearly defined? Are they directly related to the construction of the project, appropriate, and reasonable?
- Has the lead financing agency verified and recommended the adoption of the TPC and agreed to finance the same?
- Was the construction planned to be undertaken in stages and modules? Does the TPC represent the cost of only essential items and modules?
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(10) Audit of Bidding and Evaluation

- A major task to be carried out during the audit of PPP projects is the critical evaluation of the process followed by the government agency to select the private participant. Public auditors must verify the procedures followed in this regard from the beginning itself to provide assurance to stake holders about the integrity and transparency of the selection process. The basic postulate of PPP is that it should secure value for public money by ensuring transparency in the procedures followed and by ensuring adequate competition.
- Selection of the private participants by the government agency promoting the PPP Project may involve the following stages:
- Request for Qualification (RFQ)
- The RFP documents are invariably issued only to bidders who have requested for qualification and met all the parameters of RFQ.
- Request for proposals (RFP)

(11) Audit of Construction of the Project

- Public auditors are conversant with the audit of construction of projects since PWD audit has been a mainstay of conventional auditing. In PPPs, since the construction risk is transferred to the private participant who is usually responsible for the design, construction, specification and quality thereof, the emphasis of the audit scrutiny may not of that of compliance, but that of the end product .
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- The concession Agreements would provide for the appointment of "Independent Engineers" (IE) and "Independent Auditors" (IA) by the public sector partners to enable them to monitor the project activities, and to act on their behalf to accord sanctions and to coordinate the construction, technical and commercial activities. The IE is responsible to ensure the timely completion of the project by watching the milestones, quality of construction and adherence to the standards and specifications of the project by the implementing partner.

- The following criteria may be applied in the audit of construction of PPP projects.
- Did the public partner fulfill all conditions precedent which as per concession agreement were necessary for the private partner to start the construction on time?
- If there was any delay in the start up of construction, what were the attributed reasons? If there was delay on account of the private partner, was the penalty clause in the Agreement invoked?
- Were the Independent Engineer /Auditor appointed on time? Were clear terms and directions issued to them for efficient monitoring of the construction activities? Is the monitoring system in practice satisfactory?
- Were the preliminary/ pre-construction lists of the site conditions carried out in the presence of the Independent Engineer?
- Were milestones for construction (stage-wise) laid down in the Agreement achieved? If there were delays, did the Independent Engineer bring them to notice in time?
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- Was penalty as per the Agreement levied on the private partner, if there were delays?
- Did the Independent Engineer certify at every stage as to the quality of construction and adherence to specifications?
- Was there any ‘change of scope’ in the construction effected at the instance of either partner? What are the implications of such ‘change of scope’ in terms of time and capex?
- If the TPC has increased/decreased as a result of the ‘change of scope’, was necessary and consequential adjustments carried out in the TPC/VGF/Financing arrangement?
- Was the ‘change of scope’ due to faulty planning and avoidable? Has responsibility been fixed on the consultants (of DPR) or others concerned for the omission?
- In case the private partner has made innovations in design, construction and management with substantial savings in project cost or project schedule, analyze the same and impact on TPC and revenue.
- Was the project completed on schedule? If there was delay, analyze impact on cost, revenue and public interest.
- Was any penalty levied for the delay as per the provisions in the Agreement?
- Did the Independent Engineer carry out the required quality tests before giving the ‘completion certificate’? Were the test results satisfactory?
- If outside experts have been engaged to test the quality and specifications of the project construction, analyze their findings and convey the same to the partners to the PPP arrangement for their responses and comments.

(12) Audit of Monitoring of the Project Construction Activities

- The IA will verify all financing arrangements on behalf of the public sector partner, certify the expenditures where required, utilization of the VGF / annuity, and compliance of the private partner with the terms and conditions of the Agreements. He will also ensure that the items of expenditures reported are proper and reasonable, and admissible in terms of the contracts, and not 'loaded'. Further, during the O&M stage, the IA will have to certify the legality and reasonableness of revenue expenditures, verify the revenue, and audit the escrow account and report to the public sector partner to the contract.
- During the audit of the PPP, the public auditors must check the process adopted for the appointment of the IE and IA, and ensure that the required procedures have been complied with. For instance, the Secretariat of the Committee on Infrastructure, Planning Commission maintains separate panels of qualified firms for engagement as IE and IA and the PPPs are required to source these experts from them. It must also be ensured that the selected representatives have the requisite expertise and qualifications.

(13) Audit of Commercial Development

- Advertising through hoardings on the highways or at the site of the project (ports, air ports etc.), land development (in the vacant lands allotted for the project or in their vicinity), gas and service stations, duty-free shops, wayside restaurants and recreation Centre's etc.
- The Concession Agreements usually allow the JVC or the private participant to exploit these commercial openings and raise revenue which must go to abate the TPC and to reduce the burden of toll / user charges on the consumers. In public audit, care must be taken to list out the commercial facilities granted to the consortium and to examine the cost incurred for such developments vis-à-vis their earning capacity and comment on any hidden benefits to the partners concerned.

(14) Audit of Operation, Maintenance & Development and the Collection of Revenue

- *In PPP projects,* the Operation, Maintenance and Development (OMD) risk is transferred to the private partner since it would be best suited to manage the task efficiently. The Model Concession Agreement (MCA) includes the terms and conditions for the OMD which are binding on the concessionaire.
- There could also be yet another type of PPP where the concessionaire is given an OMD contract to maintain and operate an already built or existing infrastructure facility (highways constructed by the NHAI / State Government, or an existing air port constructed by the Air Port Authority of India) and collect toll or user charge etc. to meet the cost.
- Private sector participation in the operation and maintenance of infrastructure 'would require a framework that enables the private operators to secure a reasonable return at manageable levels of risk, assure the user of adequate service quality at an affordable cost, and facilitate the government in procuring value for public money'

- The selection of the concessionaire has to be based on competitive bidding, with all project parameters clearly stated upfront. The usual criteria for such concessions may be followed in the public audit, including the following:
- Is the bidding process (if the PPP arrangement is for the O&M) transparent and as per established practice? Was the bidder who offered the maximum concession fee selected for the contract? Has the successful bidder provided the required performance security / guarantee in acceptable form?
- In case the contract is awarded on upfront payment basis, was the reserve price fixed correctly and by including reliable data on traffic demands, likely increases in demand, associated income, cash flow analysis, etc.? Were these verified by independent consultants? Was the NPV of the realizable revenue worked out correctly?
- Is the concession fee subject to annual increase in proportion with the increasing traffic?
- Was action taken to notify the toll / user charge promptly and without delay? If delays occurred with impact on revenue, analyze the reasons and make appropriate comments in the audit findings.
- Are toll plazas / toll booths constructed at requisite entry and exit points to avoid leakage of revenue?
- Have electronic and computerized vehicle counting machines (VCM) been installed at the toll plazas or at other places to monitor the traffic?
- Is the categorization of vehicles and toll rates fixed correctly and as per rules? Are weigh bridges / platforms in working condition and put to effective use?
- What is the formula for indexing the user charges in line with inflation? Is it appropriate

(15) Auditing Public Private Partnerships for Value for Money Evaluation

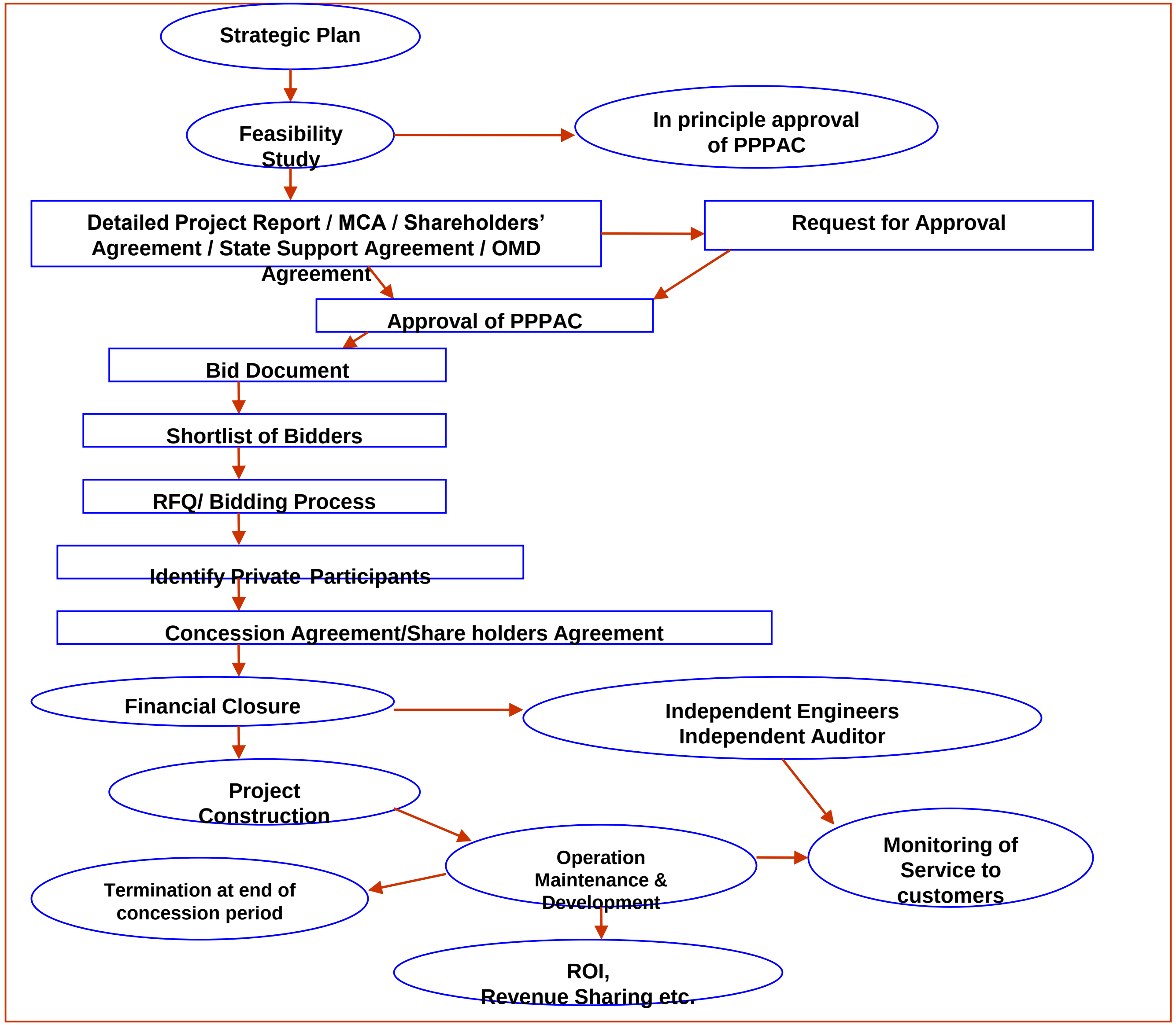
- Public auditors should look at the PPP projects not only from the angle of safeguarding the interests of the public sector partners, but also from the user’s viewpoint;
- besides, they must enquire whether the contract ensures profit sharing on equitable basis and whether there is a system to obtain regular information on the performance and in the discharge of the partner’s obligations to the public participant, as also to the users at large.
- At the end of the day, what is of utmost concern is the customer satisfaction level; the public auditors’ enquiries must be tuned to extract information on this crucial issue.
- The risk analysis should also include whether the public authority has planned to secure the best possible advice and analysis for the construction of viable solutions in the event of difficulties such as dismal performance of the partner, inability to finance the operations at some point etc., so as to avoid disruption of services to the public.

- The following questions, among others discussed elsewhere, would apply in a VFM examination of the public private partnerships.
- Has the PPP arrangement resulted in creating an efficient and economical facility/ asset for use by the public without forcing the government to commit heavy investments and avoidable borrowings?
- Has the PPP brought in technological excellence and innovation in construction and management which would reduce the cost, increase economy and efficiency and lead to better customer satisfaction?
- On the other hand, has it only led to a private sector monopoly in place of the public sector, without tangible benefits and visible advantages, to the detriment of the public?
- Has it placed a heavy future burden on the public sector by way of contingent liabilities and guarantees to be discharged at a future time? Has the agency/ government assessed and made provisions to meet the same?
- Would it have been feasible and affordable to create a project of similar quality and magnitude at a lesser cost by deploying state funds instead of depending on private sector funding and facilities? Was such an alternative feasible and affordable?

(16) Audit of Valuation of Assets

- As part of their scrutiny, auditors must verify the valuation of the assets and infrastructure facilities which exist(ed) at the time of handing over the site / facilities to the successful bidder for the construction of the project and operation and maintenance.
- An important aspect to be verified in this regard will relate to the extent and value of the land made available for the project.
- Land usually forms a major part of the asset value, especially in urban areas where the land cost is not only very high, but will keep increasing over time. It is therefore important that for the public auditors to verify that the land acquired and handed over to the private partner is not more than what is really essential for the project.
- The value of the land handed over and brought into account is to be verified carefully since in many PPP arrangements, the value of the land and facilities transferred would become the government's share capital in the JVC to be formed. The tendency to acquire large stretches of land in the name of the project and to use it for unassociated or stand-alone commercial development by the private partner needs to be commented in audit.

Flow Chart for Establishment of a Public Private Partnership Projects (PPPP)



REPORTING AUDIT FINDINGS AND RECOMMENDATIONS

- The major findings arising from the audit should be, as is the usual practice, presented at the Exit Conference. Care must be taken to support all audit findings with sufficient and relevant audit evidence. The findings must be carefully drafted to bring out full facts, evidence supporting the findings and conclusions and the arguments leading to the findings so that the public sector partner could provide its response without seeking further clarifications

- Further, the SAI’s audit examinations should not focus on narrow considerations on what went wrong; but must disseminate the good practices noted during the audit scrutiny for the information of all concerned.
- Besides, multiple audits and evaluations should not give cause to discouraging the private partner. It is also important that the auditors do not focus only on technical issues at the risk of neglecting the social and economical effects of PPPs; they should also verify whether the project has met with those objectives
- in letter and spirit. Adequate opportunities must be provided to the partners of the PPP to respond to the audit findings, and their responses should find place in the reports in case those observations are retained in the reports.

- It will be a good approach to dovetail the audit findings in line with the established objectives of the audit.
- The fact that PPP aims at innovations through technological and managerial excellence should be kept in view.
- The audit observations should not be worded in a manner as would discourage innovations and risk takings. Since the main feature of PPP is the sharing of risks in a balanced way, public auditors should not give the impression that they are against reasonable and calculated risk taking by the public sector partner.
- Though there may be no occasion to comment on the PPP policy as such, the impact of the policy on the project development and management and on the user community may be highlighted in appropriate cases, with supporting evidence.

Audit Recommendations

- Substantial care must be taken in framing the audit recommendations to be included in PPP audit reports. Recommendations, if included in the report, should be specific and precise and to the point.
- The effort should be to report on the lessons learnt rather than fault findings. The fact is that there is very little scope for amendments to the contract once they are signed and are in operation, even if the auditors point out omissions and deficiencies, unless they are patent violations to the terms of the agreements or erroneous interpretations or management failures.
- Nevertheless, the audit findings will bring out the deficiencies for future guidance as “lessons learnt”, apart from helping to make the officials who processed the agreements accountable.
- They may also be helpful for the public sector partners to negotiate for better terms in implementation of the agreements depending on the nature of such findings. Hence, sufficient care must be taken in drafting the recommendations for inclusion in the audit reports; they should not be routine and must help the government department / public sector agency concerned to implement the project in the best public interest

- It will be advisable to carry out a review of the audit findings and recommendations by comparing with the audit objectives established at the beginning as part of the audit plans, to ensure that these have been adequately met. Peer reviews of the draft reports would lend credibility to the reports.

Coverage of the aspects of the project .

- The data, records, **analysis and the decision process** of the government department / public sector agency to prefer the PPP route to execute the project instead of undertaking it directly.
- Documents and files leading to the **formulation, appraisal and approval** of the project.
- The **process of identifying the private sector partner, requests for proposals, bidding and tendering process** of the contract with due diligence to fairness, transparency and objectivity.

- **In-depth analysis of the project documents** including the shareholders' agreement, concession agreement, operation and maintenance agreement etc. , total project cost, financing arrangements (including cash flow, ROI / ERR / DCF), justification for the viability gap funding, contract period etc.
- **Accounts documents**, bills, records and schedules relating to the construction, and oversight arrangements.
- **Value for money** considerations and safeguarding the **public interest.**
- **Operation and maintenance** of the assets, tariff / toll / user-charges collection and accounting and **revenue sharing arrangements**, escrow accounts.
- **Quality and standards of the service**, customer protection, **dispute resolution** and **asset transfer arrangements** etc.
- **End of the project operations** including valuation of residual assets, decommissioning, dispute resolution mechanism, etc.