The 11th ASOSAI Research Project

Audit of Public Private Partnership Arrangements

2017
Acknowledgement

“Audit of Public-Private Partnership Arrangements” was selected as the topic for 11th ASOSAI Research Project in 49th Governing Board Meeting, held in Kuala Lumpur, Malaysia, in February, 2015. The Research Project was launched on 14th July, 2016, by the ASOSAI Secretariat. Research team for this project comprises nine SAIs – namely, the SAIs of China, India, Indonesia, Iraq, Kuwait, Malaysia, Pakistan, Philippines and Vietnam. SAI Pakistan led the research project as the Chair of the research team.

The research team would like to express its gratitude for the support and cooperation of ASOSAI Secretariat extended to us in planning and execution of the 11th ASOSAI Joint Research Project. The team also expresses its sincere appreciation to all the public institutions and corporate sector interviewees who have been forthcoming in providing information for this research work. The team would also like to express profound gratitude to the heads of participating SAIs who provided valuable assistance in this research project.

The team members of the 11th ASOSAI Research Project are as follows:

<table>
<thead>
<tr>
<th>SR. NO.</th>
<th>Country</th>
<th>Research Team</th>
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<tbody>
<tr>
<td>1.</td>
<td>China</td>
<td>Ms. Qi Yanxia</td>
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<tr>
<td>2.</td>
<td>India</td>
<td>Ms. Parama Sen</td>
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<td>3.</td>
<td>Indonesia</td>
<td>Mr. Sarjono Senior</td>
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</tbody>
</table>
| 4. | Iraq | Mr. Qasim N. Mutar
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Mr. Abdulrahman Salah Al Matooq
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Mr. Le Viet Minh
Ms. Tran Hoai Giang
Ms. Trieu Thi Thu |
<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
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<tr>
<td>AG</td>
<td>Auditor General</td>
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<td>AGP</td>
<td>Auditor General of Pakistan</td>
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<td>BAKN</td>
<td>Badan Akuntabilitas Keuangan Negara (PAC of Indonesia)</td>
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<td>CNAO</td>
<td>National Audit Office of the People’s Republic of China</td>
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<td>COA</td>
<td>Commission on Audit of Philippines</td>
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<td>COPU</td>
<td>Committee on Public Undertakings</td>
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<tr>
<td>DAC</td>
<td>Departmental Accounts Committee</td>
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<tr>
<td>DBFO</td>
<td>Design-Build-Finance-Operate</td>
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<td>DBFOM</td>
<td>Design-Build-Finance-Operate-Maintain</td>
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<tr>
<td>DBFOT</td>
<td>Design-Build-Finance-Operate-Transfer</td>
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<td>DCMF</td>
<td>Design-Construct-Manage-Finance</td>
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<td>FAO</td>
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<td>FBSA</td>
<td>Federal Board of Supreme Audit of Iraq</td>
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<tr>
<td>IA</td>
<td>Implementing Agency</td>
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<tr>
<td>ISSAI</td>
<td>International Standards for Supreme Audit Institutions</td>
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<tr>
<td>LDOT</td>
<td>Lease-Develop-Operate-Transfer</td>
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<tr>
<td>LGU</td>
<td>Local Government Unit</td>
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<tr>
<td>MOF</td>
<td>Ministry of Finance</td>
</tr>
<tr>
<td>NA</td>
<td>National Assembly</td>
</tr>
<tr>
<td>NDRC</td>
<td>National Development and Reform Commission</td>
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<tr>
<td>O&amp;M</td>
<td>Operations and Maintenance</td>
</tr>
<tr>
<td>PAC</td>
<td>Public Accounts Committee</td>
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<tr>
<td>PFI</td>
<td>Private Finance Initiative</td>
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<tr>
<td>PPP</td>
<td>Public Private Partnership</td>
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<tr>
<td>ROT</td>
<td>Rehabilitate-Operate-Transfer</td>
</tr>
<tr>
<td>SAI</td>
<td>Supreme Audit Institution</td>
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<tr>
<td>SAV</td>
<td>State Audit office of Vietnam</td>
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<tr>
<td>SPV</td>
<td>Special Purpose Vehicle</td>
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<tr>
<td>TOT</td>
<td>Transfer-Operate-Transfer</td>
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1 Introduction

1.1 Background

Public Private Partnerships (PPPs) are becoming increasingly popular for delivering multifarious public services and infrastructures. Governments are finding partnerships with private sector as effective instruments by way of making up for the short capacity of public sector vis-a-vis finance, technology and operational efficiencies. PPP arrangements have been successfully implemented in a variety of sectors for delivering various kinds of public services, creation and maintenance of infrastructure and/or development purposes like exploitation of natural resources.

PPPs are not simple contracts. PPP architecture is quite complex and, as such, requires a comprehensive understanding of the dynamics of harnessing private sector finance and expertise. The sponsoring public agency needs to have an adequate level of project management maturity to manage the complex processes of PPPs. In PPP arrangements private partners are usually awarded concessions for some public sector functions for predetermined period and, in turn, private partners are expected to make necessary investments for creation and/or management of the infrastructure or for delivering the entrusted public services. Finances are arranged by private partners and they get return on the investments usually either through charges levied on the users or through annuities received from the public authority. PPP projects may also involve a financial return to Government as well in the form of license fee, royalty, pre-determined revenue or profit share for the concession awarded, etc. The distinguishing feature of PPP arrangements is the sharing of risks between the public and the private partners. An appropriate balance of sharing of risks and gains marks the success of the arrangement.

PPPs have proven as convenient and efficient mechanism for providing public goods with limited government resources, however, it is the public partner which is solely responsible for ensuring that the services are delivered appropriately and that public assets, where transferred temporarily to private concessionaire, are kept in good condition and are being utilized in an appropriate manner for the intended purposes only. Furthermore, the sponsoring public agency is expected to devise contracts in such a way that ensures optimum cost to public with an adequate benefit for the private partner. This all bring a complex responsibility on SAIs, who being public auditors, are mandated to provide assurance on accountability of PPP arrangements.

1.2 Statement of the Problem

Although SAIs, through their audits, have been making efforts to ensure compliance of applicable authorities in PPP arrangements, by and large, accountability remains a challenge in PPPs in most of the countries. If PPPs are to gain public confidence as regards their role in
infrastructure development and service delivery, and thus serving public interests, the problem of accountability has to be addressed. Complexities associated with PPPs and associated legislative and legal issues have made PPP audits a daunting challenge for SAIs. This paper attempts to identify main accountability challenges in PPPs and make recommendations to enhance SAIs’ capacity to take up PPP audits more effectively.

1.3 Significance and Scope of Study

PPP arrangements are gaining credence in delivering public goods and for public development. Given their ability to bring in finances, state of art technology and corporate sector operational efficiency; the number of PPP arrangements and size of finances involved in such arrangements is significantly increasing year by year across the globe. This shift in mode of public sector delivery is posing a significant challenge for SAIs to ensure the accountability regarding utilization of public assets, guarantees and functions, etc.

The materiality and significance of the PPP projects, their variety and complexity and their potential impact on Governments and citizens sharpens the interest of Government auditors on audit of PPP arrangements. The so far experience of auditing PPP arrangements indicates that such audits are a paradigm shift. Such audits require acceptability not only from the public stakeholders but also from the participating private partners. To achieve this end, public auditors need to understand the complexity of PPP arrangements, get familiarize with the working culture and management style of private sector and get sensitized to the interests of the private partner who is bringing finances and sharing significant risks.

A prime concern is one of access to documents for audit. Public auditors have traditionally been accustomed to full access to the documentation relating to all aspects of project management. With significant risks and responsibilities having been placed on the private partner in the PPP model, the access to documentation is now restricted. The degree of loss of access depends on the degree of loss of control on part of the Government which in turn varies with the model of PPP employed. However, as emphasized earlier, there are significant accountability concerns that need to be addressed by the public auditor. The records in the custody of the private partner do not ordinarily fall within the ambit of Supreme Audit Institution. The desirable audit protocol in such cases where audit assurance would necessarily depend on scrutiny of records in possession of the private partner is one of practical interest and where sharing experiences across SAIs can be of significant value.

The foregoing presents a case for a focused study to appreciate the value that can be added by audit to PPP arrangements and identify the red flags for audit. Sharing experiences with other SAIs would broaden the vision and deepen the understanding on audit response to PPPs.
INTOSAI has provided the guidelines relating to audit of PPPs namely ISSAI 5220 – “Guidelines on Best Practice for the Audit of Public/Private Finance and Concessions” and ISSAI 5240 – “Guideline on Best Practice for the Audit of Risk in Public/Private”. However, SAIs are still struggling with the observance of these guidelines and having effective PPP audits. This research project focuses on the participating member countries in order to study types of PPP arrangements along with sectors where these arrangements are mostly employed and the so far audit experience of respective SAIs. Based on this information, main issues that are impeding effective value addition by the public auditor are identified and recommendations are developed to enhance the effectiveness of public auditor to give assurance on the accountability of PPP arrangements.

1.4 Project Objectives

At the start of the Research Project, the research team members held mutual consultations to decide the terms of reference (ToRs) for the Project. According to the finalized ToRs, each SAI was required to prepare its country specific research report after conducting research in its respective country. The Research Project report was required to contain recommendations with regard to audit of PPP arrangements, based on the individual SAIs’ research reports. Research objectives for the 11th ASOSAI Research Project are given as follows:

**Objective 1:** Study of the legal/statutory frameworks in place, in research team member countries, for governing and regulating the PPP arrangements.

*Research questions:*

a. Are there any constitutional/ legal requirements to be met, at the national level?

b. Are there any legal requirements to be met at state / provincial / regional level?

c. Are there rules / regulations to be met at public sector organization’s level, including state owned enterprises / government controlled or owned corporations / companies?

**Objective 2:** Identify the types of PPP arrangements and sectoral foci existing in research team member countries and their linkage with the socio-economic priorities.

*Research questions:*

a. What are the types of PPP projects prevalent in the country?

b. In which sectors PPP projects have been undertaken?

c. What are the reasons for undertaking PPP projects in a particular sector?

d. What are main motivations that promote the adoption of different type of PPP arrangements in research team member countries?

**Objective 3:** Ascertain the general risk situations faced by the State, in research team member countries, for the identified PPP arrangements.

*Research questions:*

What are the general risk situations at:

a. the conception stage of PPP arrangement?

b. the stage of entering into contract with the private partner?

c. the stage of monitoring, supervision and/or evaluation by the public sector of the mutually agreed deliverables?

d. ensuring only justified use and safety of public assets including environmental aspects?

e. the stage of transferring project or assets back to public sector? and

f. the arrangements of rewards or penalties?

**Objective 4:** Describe the role / responsibilities of research team member SAIs with respect to audit of PPP arrangements.

*Research questions:*

a. Is it legal / statutory responsibility of the SAI to conduct audit of PPPs?

b. What are the specific laws, rules or regulations that provide SAI the mandate to conduct audit of PPPs?

c. What types of audit the SAI is mandated to conduct: compliance audit, performance audit, financial attest? And

d. As per existing laws/statutes, are audit reports on PPP discussed in Public Accounts Committee of the country’s Parliament?

**Objective 5:** Study the types of audit of PPP projects thus far conducted by research team member SAIs.

*Research questions:*

a. Were there any audits of PPP arrangements conducted? If yes, then:
   i. type of audit conducted, like, compliance, value for money etc.
   ii. did the SAI find the audit experience different from other audits? Explain.

b. What are the audit objectives/foci of different types of PPP arrangements in research team member countries? And

c. What audit methods have been used to obtain enough audit evidence of different types of PPP arrangements?

**Objective 6:** Collect opinion of a representative sample of PPP projects’ management on the hitherto audits conducted by research team member SAIs.

*Research questions*

a. What are the expectations of the management from audit?

b. What are the concerns of management with respect to audit? and

c. What does the management suggest to make audit more effective for the stakeholders?
**Objective 7:** Identify the challenges / constraints faced by research team member SAIs in fulfilling their role /responsibilities with respect to audit of PPP arrangements.

**Research questions:**

a. Identify challenges / constraints due to:
   - inadequate legal / statutory framework
   - deficient skills set vis-à-vis complex types of PPP arrangements
   - lack of experience in conducting such audits
   - complex risk situations faced by the State
   - interaction with private sector management who may not be familiar with SAIs audit responsibilities, requirements, methodologies etc.
   - difficulties in accessing record
   - any other challenges / constraints

b. To what extent do these challenges / constraints affect audit effectiveness?

1.5 **Research Methodology**

This research work mostly employed qualitative method as, given the nature of the research topic, sufficient relevant data was not available to carry out statistical analysis. Literature survey was carried out to gain understanding of theoretical knowledge of PPP arrangements. Structured questionnaires were used to carry out surveys and conducting interviews for information gathering. Case studies were also employed in some cases to get in-depth understanding of PPP arrangements and related audit issues.

1.6 **Key Findings**

1. Governments are gradually becoming conscious of need of legal and regulatory frameworks to enter into PPP arrangements. As such, the related legislative and regulatory frameworks are still in the stage of evolution and would need some time to get fully mature.

2. There are unlimited possibilities of PPP arrangements depending upon the output requirements, functions assigned to the private partners and mode of payments to them. The types of PPP arrangements, though some may be more suitable for a particular sector, cannot be categorized in sector specific compartments.

3. Development of fit-for-all type of audit programs is not possible even for a single PPP type, rather the discipline of PPP audits would remain research intensive and continuously evolving as long as the PPP arrangements themselves keep on evolving. Although an indicative list of associated risks can be prepared for the guidance of auditors, each PPP audit assignment is bound to have its own detailed risk analysis in order to cover the risks to public interests exhaustively.

4. Most of the SAIs do not have explicit legislative mandate for carrying out audits of PPP arrangements. These SAIs are asserting their mandate by referring to the
provisions that provide authority for auditing wherever public resources are employed. However, such implicit references are being a source of conflict with the PPP companies or with their private partners at the least. Likewise, authority of the overseeing legislative bodies, like PACs, to give recommendations/directions to the private partners is also not explicitly clear.

5. SAI[s are not yet sufficiently experienced in auditing PPP arrangements and it would take several audit cycles before SAI[s can become as proficient in this discipline as they are in their other audit activities.

6. Designated auditee of public auditor has generally been the public partner. Private partners are generally averse towards public audits as they consider that their operations and accounts are already under scrutiny by the public partner and commercial auditors, they are not familiar with the process of public auditing and consider it as unnecessary interference in their functions and that public auditors are not sensitive to the needs of project and their focus on mere compliance of authorities sometimes hinders efficient project management.

7. Factors like variety of PPP arrangements, highly complex contract conditions; absence of explicit mandate for auditing the record laying with the private partner; apprehensive and non-cooperative private partner and capacity and mindset issues with the public auditors pose a formidable challenge to SAI[s to become the acceptable and effective auditors of the PPP arrangements.
2 Statutory Framework to Regulate PPP Arrangements

2.1 Need of Comprehensive Legislative and Statutory Frameworks

Public money is trust money to be utilized on the directions of public representatives by the civil administration. As such, stewardship and entrepreneurship over public expenditure are under strict public scrutiny. Under the complex situation of rendering space to profit oriented private sector in purely public domain a comprehensive legal and regulatory framework is required in order to protect the interests of public and private partners both.

2.2 Existing Situation in Research Team Member Countries

There exist legal /statutory frameworks to regulate PPP arrangements in all research team members’ countries. The frameworks differ from country to country in their form, but similarities are found in terms of various aspects of PPP arrangements they cover. A country-wise summary of the framework is given in the following tables:

CHINA

<table>
<thead>
<tr>
<th>Legislation / Directives</th>
<th>Issuing Authority</th>
<th>Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Guidelines for the procurement of services from the private sector on behalf of government agencies (GBF [2013] No. 96)</td>
<td>State Council</td>
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<tr>
<td>Guidelines for innovative investment and financing mechanisms involving private finance in key areas (GF [2014] No.60)</td>
<td>State Council</td>
<td>2014</td>
</tr>
<tr>
<td>Guidelines for promoting PPPs in public services (GBF [2015] No.42)</td>
<td>State Council</td>
<td>2015</td>
</tr>
<tr>
<td>Operational guidelines for PPPs (provisional) (CJ [2014] No.113)</td>
<td>MOF</td>
<td>2014</td>
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<tr>
<td>Guidance on PPPs (FGTZ (2014) No. 2724)</td>
<td>NDRC</td>
<td>2014</td>
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In addition to the above, there are also Directives / Notices issued by MOF
INDIA

At the Union level, there is no overarching legislation enabling or setting out the PPP framework. Union laws in individual sectors, however, have been amended or enacted to facilitate private participation.

A case in point is the National Highways Act, 1956 which was amended in June 1995 to allow private sector to levy, collect and retain fees from road users which facilitated PPP in construction, management and operation of national highways in the country. Another example is the enactment of the Electricity Act, 2003 which allows entry of private licensees in transmission and distribution.

Some State governments, have however, enacted laws to facilitate private sector participation in infrastructure projects.

For example, the Bihar Infrastructure Development Enabling Act, 2006 facilitates private sector participation in the designing, financing, construction, operation and maintenance of infrastructure projects in the State.

INDONESIA

<table>
<thead>
<tr>
<th>Presidential Decision No. 7</th>
<th>1998</th>
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<tr>
<td>Presidential Decision No. 81</td>
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<tr>
<td>Presidential Decision No. 42</td>
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<td>Presidential Regulation No. 13</td>
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<td>Presidential Regulation No. 56</td>
<td>2011</td>
</tr>
<tr>
<td>Presidential Regulation No. 66</td>
<td>2013</td>
</tr>
<tr>
<td>Presidential Regulation No. 75</td>
<td>2014</td>
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<tr>
<td>Presidential Regulation No. 38</td>
<td>2015</td>
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IRAQ

The order of dissolved temporary collision authority No 39 | - | 2003 |
<table>
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<tr>
<th>The Iraqi State Companies Law No 22</th>
<th>1997</th>
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<tr>
<td>The Decision No 492</td>
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<tr>
<td>The Secretariat of the Cabinet</td>
<td>2013</td>
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**Kuwait**

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<thead>
<tr>
<th>Public Private Partnership Law (Law No. 116)</th>
<th>-</th>
<th>2014</th>
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<tr>
<td>Implementing Regulations of PPP Law</td>
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**Malaysia**

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<thead>
<tr>
<th>The Malaysia’s Guideline on Privatization</th>
<th>Economic Planning Unit</th>
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<tr>
<td>The Privatization Master Plan</td>
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**Pakistan**

<table>
<thead>
<tr>
<th>The Public Private Partnership Act</th>
<th>National Assembly</th>
<th>2017</th>
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<tbody>
<tr>
<td>The Sindh Public Private Partnership Act</td>
<td>Provincial Assembly of Sind</td>
<td>2010</td>
</tr>
<tr>
<td>The Punjab Public Private Partnership Act</td>
<td>Provincial Assembly of Punjab</td>
<td>2014</td>
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<tr>
<td>The Khyber Pakhtunkhwa (KP) Public Private Partnership Act</td>
<td>Provincial Assembly of KP</td>
<td>2014</td>
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**Philippines**

<table>
<thead>
<tr>
<th>Article II Section 20 of Philippines Constitution</th>
<th>Philippines Congress</th>
<th>1987</th>
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<tr>
<td>Republic Act (No. 6957 as amended by RA No. 7718)</td>
<td>Philippines Congress</td>
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**Vietnam**

<table>
<thead>
<tr>
<th>Decree 87/CP (1993)</th>
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<tr>
<td>Decree 77/CP (1997)</td>
<td>1997</td>
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It is evident from the foregoing tables that except for Malaysia and Philippines the formulation of legislative and regulatory frameworks as regards PPP arrangements is a relatively recent phenomenon. The tables also show that the legislative and regulatory frameworks are still evolving phase.

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<tr>
<td>Decree 15/2015/ND-CP</td>
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Types of PPP Arrangements and Sectoral Foci

3.1 Definition and Characteristics of PPP

Public Private Partnership is a business relationship between a private sector company and a government agency for the purpose of completing and/or running a project that will serve the public. A broad definition of PPP is given by the PPP Knowledge Lab as "a long-term contract between a private party and a government entity, for providing a public asset or service, in which the private party bears significant risk and management responsibility, and remuneration is linked to performance".

The interest of the public partner is to arrange efficient, affordable, and sustainable delivery of public goods. The private party performs an implementing agency's functions on behalf of the public agency, usually uses public property for a project, and assumes substantial financial, technical and operational risks in connection with performance of the implementing agency's functions or use of the public property. In return, the private party receives some payment or fee for the services delivered and/or profit on investment. The extent of associated risks for the private partner in PPP differentiates between PPP arrangements and other public-private cooperation mechanisms.

3.2 Types of PPP

PPPs can be classified in terms of three broad parameters viz., the type of asset involved, what functions the private party is responsible for, and how the private party is paid.²

Assets: Many PPPs involve creating new assets by engaging private companies in financing, building, and managing new public assets, from schools and hospitals to defense facilities. PPPs can also be used to transfer responsibility for upgrading and managing existing assets to a private company. In either case, a key feature of a PPP is that the assets or services provided are specified in terms of outputs rather than inputs—that is, defining what is required, rather than how it is to be done.

Functions: The functions for which the private party is responsible vary and depend on the type of asset and service involved. Typical functions include:

- **Design**— developing the project from initial concept and output requirements to construction-ready design specifications.
- **Build or Rehabilitate**— requiring the private party to construct the asset and install all equipment. Where existing assets are involved, the private party is responsible for rehabilitating or extending the asset.

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¹https://pppknowledgelab.org/guide/sections/3-what-is-a-ppp-defining-public-private-partnership
²https://pppknowledgelab.org/guide/sections/6-ppp-contract-types-and-terminology
• **Finance**— building or rehabilitating the asset, the private party is typically also required to finance all or part of the necessary capital expenditure.

• **Maintain**—maintaining an infrastructure asset to a specified standard over the life of the contract by the private partner.

• **Operate**—the operating responsibilities of the private party vary widely, depending on the nature of the underlying asset and associated service. For example, technical operation of an asset and providing a bulk service to a government off-take; technical operation of an asset, and providing services directly to users: or providing support services, with the government agency remaining responsible for delivering the public service to users.

**Payment Mechanism:** The private party can be paid by collecting fees from service users, by the government, or by a combination of the two—with the common, defining characteristic that payment is contingent on performance.

These characteristics can be combined in various ways to create a wide range of PPP contracts. These contracts can be thought of as a continuum between public and private provision of infrastructure—transferring increasing responsibilities and risk to the private sector. The following figure depicts this continuum.
Numerous PPP projects can be derived from the aforementioned continuum. While PPP contracts can be categorized using the parameters above, there is no consistent, international standard for naming and describing these different types of contract. This varying terminology tends to create confusion when comparing international experience.

Some governments define PPP in their PPP policies or laws to mean a specific range of contract types having peculiar characteristics. Some other governments, either in law or in common usage, use other terms as synonyms for PPP like the term ‘Privatization’ or refer to other Public-Private Cooperation projects as PPP. In order to have some uniformity a useful tool is the Infrastructure Contract Nomenclature by World Bank which is explained in the following table. It covers common PPP terminology, and how each relates to the aforementioned asset type, functions, and payment mechanisms description.

<table>
<thead>
<tr>
<th>Contract Nomenclature</th>
<th>Overview Description and Reference</th>
<th>Type of Asset</th>
<th>Functions Transferred</th>
<th>Payment Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>Design-Build-Finance-Operate-Maintain (DBFOM); Design-Build-Finance-Operate (DBFO); Design-Construct-Manage-Finance (DCMF)</td>
<td>Under this nomenclature, the range of PPP contract types is described by the functions transferred to the private sector. The maintain function may be left out of the description (so instead of DBFOM, a contract transferring all those functions may simply be described as DBFO, with responsibility for maintenance implied as part of operations). An alternative description along similar lines is Design-Construct-Manage-Finance (DCMF), which is equivalent to a DBFOM contract.</td>
<td>New infrastructure</td>
<td>As captured by contract name</td>
<td>Can be either government or user pays</td>
</tr>
<tr>
<td>Build-Operate-Transfer (BOT), Build-Own-Operate-Transfer (BOOT), Build-Transfer-</td>
<td>This approach to describing PPPs for new assets captures legal ownership and control of the project assets. Under a BOT project, the private company owns the project assets until they are</td>
<td>New infrastructure</td>
<td>Typically, design, build, finance, maintain, and some or all operations</td>
<td>Can be either government or user pays</td>
</tr>
</tbody>
</table>

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| **Operate (BTO)** | transferred at the end of the contract. BOOT is often used interchangeably with BOT. In contrast, a Build-Transfer-Operate (BTO) contract, asset ownership is transferred once construction is complete. Ownership rights mainly affect how handover of assets is managed at the end of the contract. | Under some definitions, BOT or BTO may not include private finance, whereas BOOT always includes private finance |
| **Rehabilitate-Operate-Transfer (ROT)** | In either of the naming conventions described above, *Rehabilitate* may take the place of *Build* where the private party is responsible for rehabilitating, upgrading, or extending existing assets. | Existing infrastructure | As above, but *rehabilitate* instead of *build* |
| **Concession** | In some jurisdictions, concession may imply a specific type of contract; while in others it is used more widely. In the PPP context, a concession is mostly used to describe a user-pays PPP. For example, in Brazil, the Concession Law applies only to user-pays contracts; a distinct PPP Law regulates contracts that require some payment from government. On the other hand, *concession* is sometimes used as a catch-all term to describe a wide range of PPP types—for example, all recent PPPs in Chile have been implemented under the Concession Law, including fully government-pays contracts. | New or existing infrastructure | Design, rehabilitate, extend or build, finance, maintain, and operate—typically providing services to users |
| **Private Finance Initiative (PFI)** | The United Kingdom was one of the first countries to introduce the PPP concept under the term *Private Finance Initiative*, or PFI. It is | New infrastructure | Design, build, finance, maintain—may include some |

Usually user pays—in some countries, depending on the financial viability of the concession, the private party might pay a fee to government or might receive a subsidy.
<table>
<thead>
<tr>
<th>Term</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operations and</td>
<td>typically used to describe a PPP as a way to finance, build and manage new</td>
</tr>
<tr>
<td>Maintenance (O&amp;M)</td>
<td>infrastructure.</td>
</tr>
<tr>
<td>O&amp;M contracts for</td>
<td>existing assets may come under the definition of PPP where these are</td>
</tr>
<tr>
<td>Existing</td>
<td>performance-based, long-term, and involve significant private investment</td>
</tr>
<tr>
<td>Infrastructure</td>
<td>(sometimes also called performance-based maintenance contracts).</td>
</tr>
<tr>
<td>Affermage</td>
<td>An affermage contract is similar to a concession, but with the government</td>
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<tr>
<td></td>
<td>remaining responsible for capital expenditures. Affermage in particular may</td>
</tr>
<tr>
<td></td>
<td>have a specific meaning in some jurisdictions. Such contracts may or may not</td>
</tr>
<tr>
<td></td>
<td>come under the definition of PPP, depending on the duration of the contract.</td>
</tr>
<tr>
<td>Management Contract</td>
<td>The state retains asset ownership, and capital expenditure is the</td>
</tr>
<tr>
<td></td>
<td>responsibility of the public sector, whereas operation and maintenance is</td>
</tr>
<tr>
<td></td>
<td>handled by the private sector. These types of contracts are 3-5 years in</td>
</tr>
<tr>
<td></td>
<td>duration.</td>
</tr>
<tr>
<td>Franchise</td>
<td>Franchise is sometimes used to describe an arrangement similar to either a</td>
</tr>
<tr>
<td></td>
<td>concession or a lease or affermage contract.</td>
</tr>
<tr>
<td></td>
<td>Management fees extended to the contractor.</td>
</tr>
</tbody>
</table>

**Operations and Maintenance (O&M)**

O&M contracts for existing assets may come under the definition of PPP where these are performance-based, long-term, and involve significant private investment (sometimes also called performance-based maintenance contracts).

**Affermage**

An affermage contract is similar to a concession, but with the government typically remaining responsible for capital expenditures. Affermage in particular may have a specific meaning in some jurisdictions. Such contracts may or may not come under the definition of PPP, depending on the duration of the contract.

**Management Contract**

The state retains asset ownership, and capital expenditure is the responsibility of the public sector, whereas operation and maintenance is handled by the private sector. These types of contracts are 3-5 years in duration.

**Franchise**

Franchise is sometimes used to describe an arrangement similar to either a concession or a lease or affermage contract.
3.3 Types of PPPs and Sectors Involved in Participating Member States

Technical standards, management requirements and expertise required for PPPs vary widely from sector to sector, resulting in different forms of project delivery. Some common types of PPP arrangements being used in the surveyed countries are:

1. DBFOT: Design, Build, Finance, Operate, Transfer
2. DBO: Design, Build, Operate
3. BOT: Build-Operate-Transfer
4. BOOT: Build-Own-Operate-Transfer
5. BOO: Build-Own-Operate
6. BT: Build-Transfer
7. TOT: Transfer-Operate-Transfer
8. ROT: Rehabilitate-Operate-Transfer
9. Concession Contracts
10. Management/Services Contracts
11. Lease Contracts: like BLT: Build-Lease-Transfer and BOLT: Build-Operate-Lease-Transfer

These PPP models are mostly used in physical infrastructure sector. Some main subsectors in this regard are enumerated below:

1. **Transport and Logistics**: Roads and bridges, ports, inland waterways, airports, railways, urban public transport, port infrastructures like piers, wharves, quays, storage, handling, ferry services and related facilities.
2. **Urban Development**: Urban infrastructure like public transport, housing, and other civic amenities.
3. **Energy**: Electricity generation, transmission, distribution, oil and gas pipelines and storage facilities.
4. **Information and Communication Technology**: Telecommunications, backbone network, terrestrial/satellite facilities and related service facilities; IT and data base infrastructure, including modernization of IT, geo-spatial resource mapping and cadastral survey for resource accounting and planning;
5. **Municipal Engineering**: Operation and associated problems peculiar to urban life, e.g., laying out additions and parks, constructing and maintaining sewer systems, waterworks, and pavements, etc.
6. **Social Infrastructure**: Education, health and culture infrastructure.
7. **Commercial Infrastructure**: Common infrastructure for industrial parks/ special economic zones, post-harvest storage infrastructure, fertilizer, cold chain, etc.
3.4 Considerations for preferring particular types of PPP arrangement

There may be umpteen considerations for selecting a particular type of PPP arrangement depending upon the nature of sector, requirements from the project, and capacity along with willingness of the public sector and the private partner both. The PPP model used for a particular project depends on its financial viability, ownership flexibility and potential for innovation and efficiency. Generally, PPPs are concentrated in the physical infrastructure of the surveyed countries.

The Transport and Energy sectors are natural monopolies and related projects are characterized by high initial costs, a time consuming process and complicated contracts. As a result, many PPPs in these sectors are implemented in the form of variants of BOT. Municipal Engineering sector includes, inter alia, operation and maintenance of parks and other entertainment zones, sewage collection, treatment and disposal system, solid waste management systems, water supply pipelines and water treatment plants. PPPs in this sector are usually operated in the form of management contracts, lease contracts or concessions under BOT or TOT arrangements.

The complicated nature of health infrastructure and health services makes concessions the preferred form for PPPs in the healthcare sector, usually under (Private Finance Initiatives) PFI or BOT arrangements. However, depending upon the requirements, it has also been found viable to hand over health and education facilities to private partners as O&M contracts, service contracts or other such variants.

Some of the peculiar considerations while selecting a particular PPP variant are discussed in the following.

- In the projects where investment costs are recoverable fee-based IPPs are adopted in which the government grants concessions. Such projects are proceeded with under suitable BOT variant.

- In the projects where the investment costs are unlikely to be recovered with operating revenues funds/resources from the government partner are required. In such cases the government grant concessions along with a capital subsidy or direct investment. A well-structured mechanism coordinating investment, subsidy and price should be developed to enable a reasonable return on investment under such PPPs.

- For PPPs based on “government pay” rather than “user pay”, the government purchases the services and such projects are usually proceeded with under a Build-Own-Operate (BOO) or a service contract. The scope of purchase needs to be reasonably identified to make best use of the funds available.
In cases where the private concessionaire is better placed and willing to take the design risk and significant efficiency and quality advantages are expected from such transfer of design risk, variants in the nature of DBFO (Design-Build-Finance-Operate) and DBFOT (Design-Build-Finance-Operate-Transfer) are employed.

In cases where ownership is flexible and the private concessionaire can own the assets underlying the PPP, variants like BOO (Build-Own-Operate), BOOT (Build-Own-Operate-Transfer), BOOST (Build-Own-Operate-Share-Transfer) can be used.

Assets like roads and highways would always remain with the public; ownership by private concessionaire is not possible and resultanty the majority of projects in the transport sector are BOT or DBFOT variants. In cases where transfer of ownership is not possible, lease is also an option with variants like LDOT (Lease-Develop-Operate-Transfer) as has been used in case of the airports.

Where management efficiencies are the ultimate need management or service contracts with private partner are employed.
4 General Risk Situations in PPP Arrangements

4.1 Background

PPPs arrangements have been found to have following advantages over pure public projects:

1. Private sector usually produces desired deliverables more efficiently than the public sector thereby reducing their overall cost of production.

2. If there is a market competition or if profit margin dictates so, the private sector is more capable of enhancing the quality of deliverables through using innovative technology and giving more attention to user’s tastes or needs.

3. Private sector fulfills the requirements of bearing cost of capital in investment intensive infrastructure projects.

4. PPP arrangements contribute towards developing local private sector capacity by providing opportunity to work with international firms.

5. Private sector capital and entrepreneurship can be utilized through PPPs for economic restructuring aiming to encourage private enterprise in order to provide jobs in areas of high unemployment.

6. PPPs, through their investment capabilities and management skills, can be used to raise revenue by exploiting state owned assets more effectively.

However, success of PPPs depends largely on factors like, objectives of the project, design of partnership, selection of right partners and execution of the agreement with due diligence. These factors collectively result in a long list of risks at each phase of the PPP initiative. These risks are to be managed by the public partner and are to be adequately shared between the public and the private partners. As such, PPPs are not simple arrangements unlike pure public funding. Some of their peculiarities are:\(^5\)

1. Costs of procurement in PPP projects are likely to be greater than that for traditional government procurement processes. This high cost is justified only by the production of relatively efficient and better quality deliverables by the PPP arrangement. Therefore, value for money analysis is crucial in decision making.

2. The private sector makes access to finance easier however it is viable only if the cost of financing can be borne by the operating cash flows, therefore, this cost is to be borne either by the users or the government through subsidies, etc. In this regard, analysis of what would be affordable for the customers and whether the subsidies, etc., given by the government would have positive economic returns are essential.

3. PPP projects are politically or socially susceptible under certain circumstances, e.g., transferring of public sector workforce to private sector, tariff increases are required to make the project viable or if significant land or resettlement issues are involved, etc. Under such circumstances a comprehensive mitigation plan needs to be prepared for the ensuing challenges.

4. There is a limit of risk bearing by the private sector. Private firms and their lenders will be cautious about accepting major risks beyond their control, such as exchange rate risks or risk of existing assets. If they bear these risks, then their price for the service will be proportionately high. Private firms will also want to have confidence that the government would firmly standby with its undertakings regarding issues like increasing tariffs/fair regulation, etc. Private sector will also expect a significant level of control over operations if it is to accept significant risks. Therefore, in order to attract capable private partner, risk profiling, mitigation and sharing needs adequate attention at the project conception and preparation stage.

5. Private sector will do what it is paid to do and no more than that – therefore incentives and performance requirements need to be clearly set out in the contract. Focus should be on performance requirements that are out-put based and relatively easy to monitor.

6. Quality of the services would remain the responsibility of the government as citizens will continue to hold government accountable for what they are getting from the project. Therefore, the government needs to retain sufficient expertise, whether the implementing agency and/or via a regulatory body, to be able to understand the PPP arrangements, to carry out its own obligations under the PPP agreement and to monitor performance of the private sector and enforce its obligations.

7. The private sector is likely to have more expertise and after a short time have an advantage in the data relating to the project. It is important to ensure that there are clear and detailed reporting requirements imposed on the private operator to reduce this potential imbalance.

8. A clear legal and regulatory framework is crucial to achieving successful PPP management.

9. Given the long-term nature of these projects and the complexity associated, it is difficult to identify all possible contingencies during project development. Events and issues may arise that were not anticipated in the documents or by the parties at the time of the contract. It is more likely than not that the parties will continually need to renegotiate the contract to accommodate these contingencies.

Management of these risk situations and adequate sharing of risks between public and private partners are matter of concern for SAIs which are responsible for watching public interests as public sector auditors of these initiatives.
4.2 Stage-wise Risks in PPP Arrangements

PPP process is generally considered to have following main stages:

1. **Conception Stage**

   It involves project conception, need analysis, feasibility analysis, etc., and related approvals. The decision to undertake the project through PPP arrangements is taken at this stage. After taking this decision, activities like, potential indication of market interest/issuance of a Request for Interest, project complexity and risk assessment, preliminary value for money analysis, analysis of advisory service requirements, developing project schedule, develop project charter and plan for competitive procurement, etc.

2. **Preparation Stage**

   Activities involved in this stage include design of management and project structures. In particular, project output specifications, project agreement, payment mechanism, competitive process documents, updating value for money analysis and preparation of implementation plan, etc. are the main focus of this stage.

3. **Procurement Stage**

   This stage involves activities like issuance of request for qualifications, issuance of request for proposals to qualified bidders, engaging in collaborative dialogue with bidders, refining project agreement accordingly, proposal evaluations, recommendation of selected proposal and revising value for money analysis with the selected proposal information.

4. **Implementation Stage**

   Activities taking place in this stage include formation of project company and finalizing offer with the selected bidder, financial close, entering into contract, designing, constructing, commissioning, contract management and monitoring, etc.

5. **Handover Stage**

   This stage includes pre-handover preparation, performance testing, transfer of assets and performance evaluation etc.

The aforementioned model of PPP stages is only a general indicator. These stages and related activities are not universally and rigidly defined for PPP arrangements across the world. Each country may have its own variant of the given model.

4.3 Risks Associated with PPP Stages

Stage-wise lists of risks in PPP arrangements are given in this section. However, because of extensive variations in PPP project designs and multitude of possibilities in external factors, these lists are only indicative and not exhaustive. As such each audit assignment on PPP arrangement merits its own exhaustive risk analysis.
A) Project Conception and Preparation Stage

1. The requirements for entering into the PPP arrangement are not met properly (e.g., staff may not be adequately skilled to evaluate the project needs and externalities or identified projects may not be in line with the overall development objectives / strategy of the government etc.)

2. Political risks are not properly foreseen and addressed.

3. Private sector’s interest and capability in the identified project may not have been ascertained properly.

4. Substance and form of PPP arrangement are different, e.g., public sector partner is using the PPP project as a disguised financing arrangement.

5. Feasibility studies may not have been done thoroughly. For example, following aspects may not have been adequately analyzed:
   a) PPP modality, technical suitability and financial viability;
   b) Ability and willingness of customers to pay (affordability and associated revenue risk);
   c) Environmental and social impact of the project;
   d) Need for and availability of government support;
   e) Availability of key inputs;
   f) Comparison with other project candidates;
   g) Commercial risks;
   h) Conditions precedent (like, broadening of a highway project would involve acquisition of land for the expansion, environmental clearances, shifting utilities like electricity lines, etc., before the project can be implemented).
   i) Construction risks (site studies, design issues, cost overrun, time overrun etc.);
   j) Operational risks (changes in interest rates, inflation, changes in technology over project’s life);
   k) Demand risks (user volume being less than the expected or assumed level);
   l) Legal risks (changes in applicable legal / regulatory framework, issues in obtaining permit / approvals from government agencies);
   m) Political risks: (changes in government policies such as taxation, nationalization etc., changes in public opinion about the risks);
   n) Financing risks (include the ease with which the required finance can be raised for the project, as well as the cost of such finance);
   o) Feasibility study may have been prepared without consulting all stakeholders; and

6. Project proposals may not be in line with the feasibility study.

7. Faulty selection of transaction advisor or consultant, e.g., consultant is not competent or has conflict of interests with respect to the project.
8. Most efficient type of PPP arrangement for a particular project is not selected.

9. Proposed project deliverables, preliminary implementation plan and value-for-money analysis are not complete and accurate.

10. Proper assessment of financial affordability is not made particularly in case of a government-pay or government-subsidized PPP project.

11. The management structure of the PPP project is not properly designed.

12. Key economic and technical indicators are not correctly calculated.

13. Exit plan is not prepared to cater for the eventuality of the failure of the private partner.

14. Contract is not adequately designed:

   a) Project risks are not allocated between the public and private partners on the principles for optimizing risk sharing, aligning risk and reward and keeping risks under control.

   b) The government assumes risks that are supposed to remain with the private sector entity, including commercial risks associated with project design, construction, financial management, operation and maintenance etc.

   c) The investment/financing structure and payback mechanisms fail to meet the relevant policy requirements.

   d) Public responsibilities of the private partner, government-pay methods, allocation of risks, and pricing mechanisms are not clearly defined in the PPP contract.

   e) The contract price does not reflect fairly the risks borne by both parties.

   f) Conflict resolution mechanism is unclear or inadequate which might end up in undue benefits to the private partner.

   g) Key performance indicators are not sufficient to give assurance on the overall performance of the private partner.

   h) Contract conditions fail to ensure that sufficient information be provided to the public partner so as to enable adequate performance monitoring of the private partner.

   i) Weak arrangements of performance related rewards and penalties.

   j) The handover criteria (e.g. availability of equipment, minimum serviceable life, etc.) are not specified in the PPP contract.
B) Project Procurement Stage

1. There are violations of the Government Procurement Law and applicable rules and regulations in the process of procurement.

2. The procurement method is not properly chosen to meet the needs of the PPP project.

3. Criteria for pre-qualification of bidders may not have been laid in accordance with the guidelines for PPP.

4. Invitation to participate in pre-qualification may not have been advertised as per requirements of applicable rules.

5. Instructions to bidders may not have clearly specified the information required from the prospective participants regarding their legal, technical, managerial and financial capacity, etc., to undertake the project.

6. Potential bidders may not have been clearly communicated the expectations or requirements of implementing agency from the project which are necessary for enabling the bidders to develop their bids accordingly.

7. Bidding documents for inviting bids from the pre-qualified parties may not have been prepared in accordance with applicable rules.

8. Pre bid meeting with pre-qualified parties may not be held, within reasonable period of time, to provide clarifications to the parties and to discuss terms and conditions of the contract.

9. Technical Proposals may not have been properly evaluated on the basis of technical soundness, compliance with environmental standards, operational feasibility; and quality of services and measures to ensure their continuity.

10. Financial Proposals may not have been properly evaluated on the basis of, at least, the following:
   i. present value of the proposed tariff, tolls, unit prices;
   ii. present value of the proposed direct payments by the Government, if any;
   iii. costs of design and construction activities, annual operation and maintenance costs; present value of capital costs and operating and maintenance costs;
   iv. soundness of proposed financial arrangements; and
   v. extent of acceptance of negotiable contractual terms proposed by the Implementing Agency in the bidding documents.

11. The negotiated agreement may be deficient in respect of one or more of the essential provisions, like
   i. scope of work and services to be provided under the project;
ii. main technical specifications, performance standards, environmental and safety requirements;

iii. implementation milestones and completion date of the project;

iv. cost recovery scheme through user levies / fees;

v. implementation milestones and completion date of the project;

vi. cost recovery scheme through user levies / fees;

vii. performance bonds for construction works and operations;

viii. acceptance test and procedures;

ix. rights and obligations of the parties to the agreement, including risk sharing;

x. requirements and procedures for variations of the agreement;

xi. grounds for and effects of termination of the agreement including force majeure;

xii. procedure and venue for disputes resolution;

xiii. time period within which private partner should achieve financial closure of the project;

xiv. supervision mechanism of the implementing agency.

C) Potential risks associated with project execution stage

1. The private partner fails to provide funds in full or on time as agreed in the PPP contract to form the project company.

2. The project company is not effectively and efficiently managed.

3. There are construction delays or design change that result in significant increase in the construction and operation costs.

4. The public partner’s payment obligations under the PPP contract are not included in the government’s budget plan or payments are made against the regulations on budget management.

5. The public partner’s payment obligations under the PPP contract are not included in the government comprehensive financial report.

6. Public funding is withheld, idled, used inefficiently, diverted to some other project or wasted.

7. Government intervention becomes excessive and makes project inefficient.

8. The PPP project assets fail to meet the capacity or efficiency requirements or deliver the public services stated in the PPP contract.

9. The private partner or project company violates contract provisions, environment regulations or code of conduct.
10. Midway corrections to project execution are not managed appropriately in order to protect public interests.

11. The public partner / private partner / project company fails to meet the requirements for mandatory information disclosure.

12. Description of supervision and monitoring mechanism in the PPP contract is vague making the roles and responsibilities of the parties may unclear, hence timely monitoring, evaluation and feedback may get affected.

13. Proper expertise to monitor the execution of the contract is not available. For example, independent experts / engineers may not have been appointed to verify the contents of periodic reports such as construction work progress report, operation and maintenance report, revenue collection report, financial reports etc. submitted by the private partner

D) **Potential risks associated with project handover**

1. The project fails to meet the handover criteria given in the contract.

2. The asset appraisal and performance testing plans are not thorough, e.g., excessive compensation is allowed.

3. There have been hidden defects in the handed over project assets which potentially impact future deliverables (risk of latent defects).

4. After the project handover is completed, the fiscal authority fails to arrange a performance review of project deliverables, cost efficiency, regulatory effectiveness and sustainability etc.

5. Technology used has become inefficient or obsolete.
5 Existing Mandates of SAIs to Audit PPP Arrangements

Actual audit authority of SAIs varies from country to country. However, SAIs are typically mandated to audit only government agencies and entities wholly or majority-owned by governments. As such, some SAIs do not have clear mandate to audit PPP companies. Nonetheless, the private partner of a PPP company may hold a lot of relevant information which is necessary for conducting an effective audit. Lack of clarity on the access to the information held by the private partner is a potential source of conflict. This chapter delineates the roles and responsibilities of research team member SAIs with respect to PPP Audit arrangements as provided in their respective constitutions and statutes.

5.1 Statutory Mandates of SAIs with Respect to PPP Audits

Most of the member countries SAIs draw their mandate to operate from their respective constitutions. Nonetheless, based upon certain legal peculiarities, the authority to audit varies.

SAI CHINA

The Audit Law of the People’s Republic of China (“Audit Law”) was promulgated on January 1, 1995 and amended in February 2006. The Audit Law, as the basic law on auditing and the core of audit legislation, stipulates the national audit system of China. The Audit Law provides a comprehensive set of regulations on national audit, i.e. the basic principles of audit supervision, auditing agencies and auditors, duties and functions of auditing agencies, powers of auditing agencies, auditing procedures and legal responsibilities etc. In addition to the Audit Law, relevant financial and economic laws, e.g. the Accounting Law, the Budget Law, the Government Procurement Law and the Law on the State-Owned Assets of Enterprises, form an integral part of China’s audit legislation.

With regard to the legislative aspects of PPP audits, local governments have been working on legislation to regulate PPP audits. As and when authorized by the local government, auditing agencies will audit construction projects implemented under public private partnership arrangements that involve general public stakeholders. Although it hasn’t been signed into law or ministerial regulations that PPP audits are mandatory, the role of auditing agencies and the scope of auditing set forth in some policy documents have dealt with the attributes of PPP projects, thus providing the basis for determining whether PPPs are subject to national audit.

The State Council Guidelines emphasize on conducting of audit of all those projects and ventures that draw in the involvement of public officials and/or the utilization of public funds; therefore, PPPs can be attributed to fall under the category of mandatory audits.
SAI INDIA

SAI-India derives its audit mandate from article 149 of the Constitution of India which lays down the duties and powers of the Comptroller and Auditor General of India (CAG). Drawing from the constitutional provision, the role and responsibility of SAI-India has been defined in the Comptroller and Auditor General’s Duties, Powers and Conditions of Service Act, 1971 (CAG (DPC) Act, 1971). Under the provisions of the Act, the audit mandate of SAI-India covers all public institutions, - the Government (as the sole auditor of the Union and State governments); public bodies and authorities; public sector enterprises (Government companies). The Regulations of Audit and Accounts (2007) lays down that audits taken up in exercise of this mandate are broadly categorized as financial audit, compliance audit and performance audit. As per the Act (section 23 of the CAG (DPC) Act, 1971), the scope and extent of audit shall be determined by the CAG.

Audit of PPP arrangements is taken up by SAI-India based on their risk perception, materiality and significance. A set of auditing guidelines ‘Public Auditing Guidelines for PPP in infrastructure projects’ have been issued for informing and advising the objectives, scope and process to be followed for audit of PPP arrangements. The audit mandate of SAI-India encompasses the audit of public promoters/ partners in a PPP arrangement. As such, full audit trail regarding decisions taken by the public partner in the PPP arrangement is available for scrutiny. With significant risks and responsibilities being transferred to the private partner in a PPP arrangement, access of public audit is somewhat fractured; the degree of loss of access depending on the degree of loss of control on part of the public partner which varies with the model of PPP that has been employed.

The access of public audit to records of private partners has been debated with some disputes having been referred to the courts. The Supreme Court of India (in its judgment of 17 April 2014) clarified the auditability of revenue sharing arrangements. The Court held that the constitutional mandate of CAG of India is not confined to accounts of the Union or the State Governments and other bodies and authorities prescribed under law by the Parliament or State legislatures “but also to audit all transactions which Union and State have entered into and which has a nexus with Consolidated Fund, especially when the receipts have direct connection with revenue sharing”. Thus the Supreme Court judgment has given a boost to audit of PPP arrangements, particularly in cases where the arrangement involves revenue sharing with the Government/ public partner.

SAI INDONESIA

The audit mandate of BPK (SAI of Indonesia) has been stated in Article 23(E) of Indonesia’s Constitution. Further, Article 2 of Law No. 17 of Year 2003 states:

“State Finances as referred to in Article 1 paragraph 1, include: state/regional assets managed on its own or by other parties in the form of cash, securities, receivables, goods
and other rights that can be valued in money, including assets separated on state enterprise/local company; and assets of other parties obtained using facilities provided by the government”.

Accordingly, PPP projects are placed under the scope of state finance, and as such falls in the audit jurisdiction of SAI Indonesia.

**SAI IRAQ**

Federal Board of Supreme Audit (FBSA) of Iraq was established under the law No. 17 of 1927. FBSA derives its mandate from third item of Article 73 of the Iraqi Constitution. FBSA implements its tasks in accordance with the Law No. 31 of 2011 (amended) entitled as the Law of Federal Board of Supreme Audit. Paragraph 4 of the Law of FBSA stipulates that:

“FBSA audits and controls public money wherever it is found”

The above statute suffices as a legal footing for carrying out the audit of PPPs.

**SAI KUWAIT**

The Court of Accounts was established under the Law No. 30 of 1964. The SAI of Kuwait draws its mandate to conduct the audit of PPPs in accordance with the Article 31 of Law No. 116 of 2014 on the partnership between the public and private sectors, which stipulates that:

"all subject to partnership contracts to be concluded in accordance with the provisions of this Act, including consultancy contracts oversight prior and subsequent to the Audit Bureau, according to the rules of censorship stipulated in law No. 30 of 1964 ".

**SAI MALAYSIA**

The Audit Act 1957 is the legal document which authorizes the SAI Malaysia to conduct the audit of accounts of not only all public-sector entities but also of all those bodies which get full or partial funding from the government whether through grants or through loans. Section 5(d) of the ibid act is to be referred in this regard verbatim text of which is reproduced below:

“The duties of Auditor General, which are to examine, enquire into and audit, amongst:

(d) the accounts of any other body, including a company registered under the Companies Act 1965, in receipt of a grant or loan from the Federation or a State, and including also a company where more than half of its paid-up share capital is held by the Federation, a State or a public authority or is so held in the aggregate by two or more of them”.
SAI PAKISTAN

The SAI Pakistan draws its mandate to conduct audit from the Constitution of the Islamic Republic of Pakistan. Furthermore, the Auditor General's (Functions, Powers and Terms and Conditions of Service) Ordinance, 2001 describes the functions and powers of the Auditor General Pakistan.

Section 8 of the Ordinance, 2001 states that the AGP shall audit all expenditure from the Consolidated Fund of the Federation and of each Province; audit all transactions of the Federation and of the Provinces relating to Public Accounts; audit all trading, manufacturing, profit and loss accounts and balance sheets and other subsidiary accounts kept by Order of the President or of the Governor of a Province in any Federal or Provincial department; and audit, subject to the provisions of the Ordinance, the accounts of any authority or body established by the Federation or a Province, and in each case to report on the expenditure, transactions or accounts so audited by him.

Section 9 of the ordinance provides for the mandate of the Auditor General in case of authorities which are financed by governmental loans and grants subject to the provisions of any law for the time being in force applicable to that body or authority.

Section 11 (1) & (2) provides that where any grant or loan is given for any specific purpose from the Consolidated Fund of Federal Government or of any Province or of any district to any authority or body, not being a foreign State or international organization, the Auditor-General may scrutinize the accounts by which the sanctioning authority satisfies itself as to the fulfillment of the conditions subject to which such grants or loans were given and for this purpose have the right of access to the books and accounts of that authority or body, provided that the President, the Governor of a Province or the authority of a district, as the case may be, is of the opinion that it is not necessary to do so in the public interest.

Section 12 provides that the Auditor-General shall audit all receipts which are payable into the Consolidated Fund or Public Account of the Federal Government and of each Province and in the accounts of each district.

Public Private Partnership Authority Act, 2017, of Government of Pakistan defines a "public private partnership" as a commercial transaction between an implementing agency and a private party. Under the terms of the transaction, the private partner performs function(s) of public partner, assumes the use of public property for project and also accepts substantial risks in performance of public partner’s functions or use of public property. In return, private partner

i. gets paid by the public partner from its budget/revenue;
ii. collects fees from users of service provided to them; or
iii. gets a combination of both (i) and (ii) above.
In case of (i) above, when the public partner makes entire payment from public funds to a private partner as a return for performance of certain public function(s), the mandate of AGP to audit the PPP transaction is established in terms of the Articles of the Constitution and Section 8 of the AGP Ordinance 2001. Even, in case of a payment made in the form of loan to finance a PPP arrangement, the audit mandate is established by Sections 9 and 11(1) of the Ordinance 2001, though the nature and extent of audit may need to be modified. This will depend upon factors such as the terms of the loans, the extent of project cost financed through loan etc.

However, neither the PPP Act nor PPP contracts provides for audit of private partner’s accounts by the government auditor. The main argument presented by executing agencies regarding not including such clauses in PPP contracts has been that it would shy away the private entrepreneurs. Insofar as subjecting the PPP transaction to audit from project identification till the award and signing of the PPP contract is concerned, it may not be problematic. All the relevant record / documents would be available with the public partner. However, if auditors, in connection with their audit, require any documents or records that form part of the accounts of the private partner, the auditors shall have to requisition the same through the public partner and the public partner shall be able to provide the same only if provision of such record is covered under the contract.

As far as audit of receipts of toll/user fee is concerned, Auditor General’s mandate is established by Section 12 of the Ordinance, 2001, if the same is to be deposited in to public fund. However, if the private partner is given the right to collect and retain toll / user fee over the concession period, the scope of audit of receipts would definitely been affected.

**SAI PHILIPPINES**

The Commission on Audit (CoA) is the Supreme Audit Institution (SAI) of the Philippines. RA No. 6957 (as amended) stipulates the mandate of the Commission on Audit insofar as audit of PPP arrangements is concerned. Section 12.19 thereof provides that:

“All revenues, share and/or receipts pertaining to or accruing to the Agency/LGU derived from any project proposed under the Act and these Revised IRR, including expenditures or use of funds and property, owned or held in trust by, or pertaining to the Government, shall be subject to examination audit by the Commission on Audit (CoA), including

i) ensuring that such revenues, share and/or receipts are fully and properly accounted for and remitted to the Agency/LGU, and

ii) determining if the mandated return on rate base is complied with, in the case of Public Utility Projects”.

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The Auditor General (AG) is the head of SAV and would be elected by National Assembly (NA). AG is responsible, and would report on audit results and his or her work, to NA. When NA is in recess, he or she is responsible, and shall report on his or her work, to the Standing Committee of NA. Article 3 of the State Audit Law stipulates that both public finance and assets are the objects of SAV.

Article 3 stipulates that Public finance includes: “State budget, national reserves, state financial fund not included in state budget. Finances of state agencies, People’s Army, public administrative units, service providers, public goods, political organizations, socio-political organizations, social organizations, social-professional societies which use state funds or budget; the state’s portion of capital at enterprises and public debt” and Public assets: “Land, water resources, mineral resources, benefits from coastal areas, space areas, other natural resources, state assets at state agencies, people’s army, public administrative units, political organizations, socio-political organizations, social organizations, social-professional societies; public assets assigned for enterprises to manage and use; the State’s reserved assets, infrastructure assets serving the public benefits and other assets invested by the State and belong to the people, and the State represent to own and manage them”.

In Articles 12, 13, 14 of the State Audit Law the rights, responsibilities and legal status of AG are clearly defined to preserve independence and integrity in the auditing activities of SAV.

In accordance with above-mentioned regulations in the articles of the Constitution and the State Audit Law, SAV not only audits the management and use of public finance, but also oversees and evaluates all activities relating to the management and usage of public assets and public finance, whether invested by the private sector or by the state.

PPP is the joint investment of the state and private sector. In PPPs contracts are signed between an authorized state agency and investors to build infrastructure facilities. Investors are responsible for mobilizing capital and investing in the constructions. Upon completion, investors operate the constructions for a limited period of time, after the contract period, the investor must transfer the construction to the State. Investors may also choose to build infrastructure facilities or public facilities, in exchange the State will return the investment capital to investors (in the form of land or money). As all these constructions are also public assets, PPP investment projects must be audited by SAV. Another reason that PPP should be audited by SAV is that, checking and finalizing PPP constructions is essential to determine the amount of tolls and the period of collecting them, which is directly related to the State’s benefit.

Moreover, the entire PPP process, from preparing investment and investment policies, formulating and appraising projects, opening bids, compensating for land acquisition, compensating contracts, etc., involves participation of many ministries, departments or
provincial People’s Committees and the whole process is also governed by many regulations in specialized legal documents.

Keeping in view the nature of PPP arrangements SAV has the mandate to audit PPP projects in accordance with regulations of the State Audit Law, and specifications and procedures issued by SAV.

5.2 Mandate of Parliamentary Committees as regards PPP Audit Reports

The SAIIs of member countries conduct audit and principally lay these report before the legislature, mostly through specific committee established for the purpose, to review these report and issue appropriate recommendations and directives to the administrative departments. These legislative committees are often responsible for following up the audit recommendations as well. In the following paragraphs, mandate of such committees will be looked at in overall perspective and in the perspective of PPP audit.

SAI China

Under the Audit Law of People’s Republic of China, the State Council and the local governments at or below the county level shall submit to the standing committee of the people's congress at the same level an audit work report issued by the auditing agencies.

The standing committee of the people's congress usually follows an agenda that combines the hearing of the audit work report and the review of the audited government financial report. Before the audited government’s budget outcome report are reviewed and approved, the committee will listen to the budget outcome report issued by the financial department and the audit work report issued by the auditing agency for budget implementation and other fiscal revenues and expenditures, in order to have a comprehensive and objectively grasp the government’s financial management and strengthen the supervision of budget implementation and other fiscal revenues and expenditures. The committee will urge the government to take actions to solve the problems in budget implementation, make sure budget implementation is taken seriously and ensure an effective role of the people’s congress in budgetary supervision. The Audit Law also requires the State Council and the local governments at or above the county level to report to the standing committee of the people's congress at the same level about the rectification of problems identified in auditing to ensure the corrective measures are implemented effectively.

SAI India

SAI-India, in the course of auditing PPP arrangements, has made specific recommendations based on audit conclusions which were expected to improve the management of PPP projects. These recommendations have been discussed with the public promoter/ partner and, in most of the cases, have been accepted by them for implementation.
After the audit reports are tabled in the Parliament, they are referred to parliamentary committees (Public Accounts Committee (PAC) and Committee on Public Undertakings (COPU)) which examines the audit report, engages with the audited public entity, ensures suitable corrective actions are taken and also recommends better practices for future implementation.

**SAI INDONESIA**

State Finance Accountability Committee of the Peoples Representative Council (DPR) of Indonesia works as the Public Accounts Committee (PAC) of Indonesia. The State Finance Accountability Committee (Indonesian: Badan Akuntabilitas Keuangan Negara (BAKN)) is an auditory body of the legislative branch in Indonesia's political system and was established under Paragraph 6 of Indonesian Law No.27 of 2009 enacted on 29 August 2009.

Main functions of the BAKN include the following:

- undertaking scrutiny of the findings of audit results of the BPK which have been laid before the Indonesian Peoples Representative Council (DPR);
- sending the results of its scrutiny to the commissions;
- following up the results of commission discussions on findings of the audit results of the BPK at the request of the commissions;
- giving input to the BPK in the matters of the annual audit work plan, audit impediments, as well as the presentation and quality of report.

Based on Law no. 17 of 2014 regarding First Amendment of Law no. 27 of 2009, the BAKN was dissolved or abolished and its functions are returned to DPR’s respective commissions.

**SAI IRAQ**

The Federal Board of Supreme Audit (FBSA) of Iraq conducts audit including those of PPP projects, prepares reports, and communicates these reports to legislative authority. The legislative authority uses these reports to ascertain whether the executive authority’s reports conform to the rules, policies, and procedures. Further, the legislative authority uses these reports for the purpose of future administrative and financial decisions regarding the executive authorities and the projects.

**SAI KUWAIT**

Decision No. 43 of 1999 entrusted the Court with the task of establishment of a Control Unit for the purpose of performance management.

The evaluative control over the performance of the Audit Bureau is ensured through applying the latest financial control methods. The objective of the Control Unit is to observe whether the Audit Bureau is functioning properly and is evaluating the executive authorities.
to the extent to ensure that the state budget targets are met with and thus the achievement of economic and social objectives of the society is safeguarded. The Control Unit also aims to detect the efficiency of the administrative units and makes the necessary proposals to improve the quality of their performance in order to evaluate activity the government itself.

**SAI MALAYSIA**

The Public Accounts Committee (PAC, Jawatankuasa Kira-Kira Wang Negara) is a standing committee of the Dewan Rakyat, the lower house of Parliament of Malaysia.

Mandate of the PAC includes:

- Review and report on the Public Accounts of Malaysia
- Examine all reports of the Auditor General of Malaysia

**SAI PAKISTAN**

The audit reports prepared by the Department of the Auditor General of Pakistan are discussed in the Public Accounts Committees of the National and Provincial Assemblies. Article 171 of the Constitution states the procedure for disposal of the audit reports produced by the Auditor General:

“The reports of the Auditor General relating to the accounts of Federation shall be submitted to the President, who shall cause them to be laid before the National Assembly and the reports of the Auditor-General relating to the accounts of a Province shall be submitted to the Governor of the Province, who shall cause them to be laid before the Provincial Assembly”.

The audit reports, before finalization and submission to the President or Governor, are discussed at the Departmental Accounts Committee (DAC) level. The DAC comprises of Principal Accounting Officer of the audited entity, and the representatives of the AGP and the Ministry of Finance. An audit report on a PPP project once processed and finalized would be laid before the Parliament / Provincial Assembly for discussion by the respective PAC.

**SAI PHILIPPINES**

The Commission on Audit as an independent constitutional body is apparently not under obligation to comply with the directives of the Public Accounts Committee of the Congress insofar as PPP Audit Reports. As mentioned above, COA has the exclusive authority to define the scope of its audit and examination, establish the techniques and methods required therefor, and promulgate accounting and auditing rules and regulations, including those for the prevention and disallowance of irregular, unnecessary, excessive, extravagant, or unconscionable expenditures or uses of government funds or properties.
State Audit Vietnam (SAV) has the duty to report audit results to the Government, National Assembly or its Standing Committee.

In accordance with clause 4 Article 55 of the State Audit Law the State Audit shall have to send audit reports to the audited unit and relevant agencies, as stipulated by SAV, no later than 45 days, from the date of completion of the audit conducted at the audited unit; in exceptional circumstances, this period may be extended to be not more than 60 days, from the date of completion of the audit conducted at the audited unit. Article 56 provides for making and sending of extraordinary audit reports: Based on the nature of audits, the State Audit shall make and send extraordinary audit reports to NA, the NA Standing Committee, the Nationality Council, NA's Committees, the State President, the Government and the Prime Minister.
This chapter highlights the types of PPP audits conducted by research team member SAIs, envisaged objectives to be achieved through these audits, and the methods adopted by the research team member SAIs to carry out such audits.

6.1 SAI China

As PPP is still in its infancy in China, improvements are yet to be made in the areas such as legislation, institutional capacity and best practices etc. CNAO is investigating the various types of PPP audit, methods and procedures as well as reporting requirements, amidst an evolving legal and policy environment. Local audit offices have conducted only a couple of project audits in an exploratory manner. However, a theoretical analysis of PPP audits is discussed in the following.

National Audit Office of the People’s Republic of China (CNAO) evaluates PPP projects through multiple dimensions, i.e. policy implementation, regulatory compliance and investment performance etc. In view of the inherent nature of PPPs, a life-cycle approach should be adopted for PPP audit from the perspective of national governance to audit and evaluate PPP projects at a multiple of dimensions, i.e. policy implementation, regulatory compliance and investment performance etc. In addition, given the role of the government in PPPs, PPP projects audit inevitably involves compliance audit, performance audit, national policy implementation audit and livelihood audit etc. As a result, a PPP audit combines a range of audit procedures characterized as preventative, well-timed, ongoing and extensive (the scope of audit).

The core objectives of PPP audit have been identified by the CNAO as under:

- **Ensuring effective communication of public policies**: PPP audits will oversee the steps taken by the local authorities and departments in implementing the national policy guidance for PPPs, review the progress and results achieved to identify problems, and analyze root causes in a timely manner.

- **Facilitating rectification and accountability**: PPP audits will uncover major problems in the entity being audited, such as inaction, delay in action and false action; identify material malpractice and misconduct, loss and waste, risks and dangers, and irregularities and violations etc.; and will suggest corrective measures.

- **Promoting institutional innovation**: PPP audit activities will help creating new methods and rules in line with the PPP policies and requirements. Based on the findings of such audits; laws, regulations and rules that are outdated, restrictive or
obstructive will be removed or amended accordingly.

- **Bolstering structural reform in the supply-side:** PPP audit activities will contribute to the ongoing efforts in streamlining exploratory practices, identifying innovative approaches and introducing new institutional mechanisms. These audits will help putting forward constructive ideas to address mismatched, unaligned and even contradictory measures in PPPs and will make sure that related reforms are carried out effectively. In this way these audits will help in bolstering the provision of national infrastructure and public services through streamlining the joint endeavors in delivering infrastructure projects and public services.

Currently, CNAO proposes the use of a range of methods and procedures to conduct PPP audits including special investigations, follow-up audits, large-scale centralized audit programs, big data-driven audits etc.

### 6.2 SAI India

Audit of PPP arrangements is taken up by SAI-India based on their risk perception, materiality and significance. A set of auditing guidelines ‘Public Auditing Guidelines for PPP in infrastructure projects’ have been issued for informing and advising the objectives, scope and process to be followed for audit of PPP arrangements. The audit of PPP arrangements is mostly driven by the specific audit question. The audit trail for addressing the audit question may well be entirely available with the public partner. In a few cases, the audit investigation may lead to areas where complete documentation is not available with the public partner (which continues to remain the auditee for the public auditor) and access to records of private partner becomes essential. As clarified by judicial pronouncements, access, in such cases is not denied to SAI-India and can be enabled through the public partner (auditee) or be asserted in public interest.

Audits of PPP arrangements have been carried out by SAI-India both at Union and State government level. Though PPP models have been operationalized across a number of infrastructure sectors in India, it has been most extensively employed for transportation infrastructure; - e.g., highways, ports, airports. Accordingly, SAI-India has carried out a number of audits in this area.

Primary objectives of the PPP audits have been to derive assurance that the interests of the public partner in the PPP arrangement have not been compromised and that the PPP model has provided the best value for money in implementation of the project. At the same time, the quality of service being provided to the users and the interests of the public users of the infrastructure project has been kept in view by audit. Concerns regarding design of certain PPP projects have been raised in audit.
6.3 **SAI Indonesia**

To date, BPK has undertaken audits of only two PPP projects, both of which can be categorized as State-Owned Enterprises. Findings of both audits indicate that the BPK and the GOI should seek to prioritize and expand PPP audits.

According to Law, BPK can conduct three types of audits i.e. financial audit, performance audit, special purpose audit (compliance audit or investigative audit). BPK auditors may conduct performance audits and compliance audits of PPP projects.

Audit objective was to assess the compliance of regulations by the PPP projects management related to infrastructure financing and guarantees and to obtain the adequate understanding of internal control systems in order to assess the risk and reasonability of control for safeguarding of project assets and assess whether the internal control system was designed and implemented adequately to achieve the objective of control.

Audit methods employed were to collect data by sample, interview, confirmation and limited physical observation. Furthermore, there was evidence analysis and conformity assessment between the evidence and the audit criteria. The results of the assessment were set forth in the form of audit findings used to formulate the conclusions of audit and improvement suggestions.

6.4 **SAI Iraq**

FBSA – the SAI Iraq conducted PPP audits of various PPP entities and found following deficiencies:

- The contracts entered into by the public companies were nominal and non-technical;
- The laws and instructions issued by the legislators regarding PPP operations were not being followed in true letter and spirit;
- In practical sense, most of the PPP projects remained unable to achieve their objectives;
- Many clauses of the contracts like delay penalty, breach of the contract, bill of quantity etc. were not activated;
- Many of the contracts could not achieve their objectives; the public partners were made to bear undue liabilities;
- The agreed upon contracts were unable to add value to the productive efficiency of the public partner;
- Many private partners managed to go around the legal formalities (including the certificate of origin, maps and engineering designs, delay penalties etc).
- The key ministry i.e. Ministry of Industry and Minerals remained casual and offhand while dealing with private partners. Instead of taking proactive punitive measures
against the breaching parties to ensure non-recurrence of lapses, it confined itself to mere supporting of FBSA’s recommendations.

6.5 **SAI Kuwait**

SAI Kuwait conducts PPP audits keeping following main objectives in view:

- Compliance with legal, technical and financial conditions contained in the contract;
- Verify the accuracy of financial extracts from the work done and compliance with the enclosed documents and the adequacy of these documents;
- Commitment to the program prepared for the implementation phases during the contract period.

The audit bureau verifies that spending on construction projects have been in accordance with the terms of contracts with contractors, and exchange orders have been issued by proper and competent authority and they are accompanied by documents and appropriate clearances. In addition, the audit bureau also tends to verify that the special disbursement accounting entries have been made in a radical and systematic manner in accordance with the financial and accounting regulations and the general rules of the budget. Moreover, making sure that appropriate procedures have been adopted for securing credits by the construction projects as defined by various circulars of the Ministry of Finance.

6.6 **SAI Malaysia**

Performance auditing is the primary type of audit conducted by the SAI Malaysia on PPP arrangements. Referring as value for money auditing, it is an independent audit of Government agency or unit, to assess the effectiveness and efficiency of its utilization of funds.

Performance Auditing is conducted to appraise whether Government programs or activities are executed in an effective, efficient and economical manner and achieve their intended objectives.

The audit methods used to conduct the performance auditing on PPP arrangements include:

- Physical Inspection
- Confirmation
- Documentation
- Observation
- Inquiry
- Re-performance or recalculate
- Analytical procedure
The limitations identified by SAI Malaysia in implementing audit recommendations are the relevancy and timeliness of the recommendations whether these are practical to be implemented within the budget and resources constraint in the audited agencies.

6.7 SAI Pakistan

The PPP Audit is a new concept for SAI Pakistan. Only a few Field Audit Offices (FAOs) have conducted PPP Projects’ audit in the country so far. The SAI carried out compliance with authority audit on three major PPP projects in the field of construction, highways, and mass transportation.

The focus of PPP audits, unlike audit of the government departments and entities, was on PPP contract, validity of total project cost, economy and efficiency of operations of the entity as seen from the public partner’s point of view and above all on achieving the objectives (results) of the Following audit methodology was adopted by the SAI:

- detailed scrutiny of project documents starting from the conceptual stage to the project formulation and approval stage;
- review of concession agreement, minimum revenue guarantee agreement, mark-up security guarantee agreement and Escrow Account agreement entered into between the Government of Sindh and the Private Partner;
- review of PPP financial model partnership rather than on how the private partner secured goods and services for the project.

6.8 SAI Philippines

Audits of PPP projects in the Philippines are conducted either through regular annual audit by resident audit teams or special audits by visiting teams.

The scope of regular audits of IAs normally includes financial, compliance and VFM audits. The audit of the PPP project is conducted only in the course of the audit of the operations and the financial statements of the IA for the calendar year and therefore, does not focus solely on the PPP project. On the other hand, the scope of special audits focuses solely on the specific PPP project which is the subject of the special audit and is more comprehensive compared to the regular audit conducted by resident audit teams of IAs.

The following have been the audit objectives for actual audited PPP arrangements:

- To verify compliance with applicable rules and regulations of the concession agreement entered into by the agency and its private counterpart;
- To determine whether the project is being used, completed on time and had reduced the travel time of the intended beneficiaries.; and to determine whether all the affected residents on right of way (ROW) were paid with just compensation and duly supported with the required documents;
• To determine whether the procurement strictly followed the Philippine BOT Law Revised;
• To verify whether the procurement is not disadvantageous to the government; to verify whether related expenditures are accurate, valid and authorized; and to validate whether capitalized expenditures are in accordance with the generally accepted accounting principles and auditing standards;
• To assess the efficiency and effectiveness of the implementation of BOT projects under the ICT sector in protecting the interest of the government and the public.

In order to obtain enough audit evidence in auditing the sample PPP projects, following audit procedures were employed:

The Audit teams reviewed relevant standards, model guidelines, frameworks on BOT Law, attended briefings and interviewed concerned officials of BOT/PPP Center, evaluated the reasonableness of contract provisions and compliance with relevant BOT regulations, reviewed and evaluated accomplishment reports, reviewed procedures and criteria adopted for the bidding process, reviewed pertinent project documents, reviewed general and application controls concentrating on the adequacy of internal control in the application systems and deliverables under the project.

6.9 SAI Vietnam

PPP project auditing is a new responsibility of SAV – the SAI Vietnam. The types of audits conducted by the SAI are mainly compliance auditing, financial auditing and preliminary evaluation of the economy, efficiency and effectiveness of PPP projects.

Objectives of the PPP audits so far conducted by the SAI include the following:

• Confirm the accuracy and integrity of the Financial reports (sources of capital, investment cost);
• Evaluate the compliance with laws policies and mechanisms on the management of construction investment and regulations on BOT contracts;
• Evaluate the economic efficiency in managing and using capital
• Identify violations and request audited units to improve their financial-accounting management, activities and make recommendations to authorized agencies for discipline;
• Provide reliable information and data to the NA and state management agencies to monitor the management of BOT projects.

SAI audit teams conducted audit of PPP projects using basic methods in investment project auditing procedures like checking of materials, observation, interview, recalculation etc.
Views of PPP Project Management Regarding Public Audits

The surveyed SAIs have been conducting compliance and performance audits of PPP projects. Since PPP is a relatively new phenomenon, audit efforts in this field are still in a nascent phase. The designated auditee has so far been the public partner. Audit focus is generally on the contract management by the public partner and overall interests of the users of the project and public at large. Though audit assurance may require access to certain records of the private partner, direct audit of the private partner has not so far been possible. Such record is usually obtained through the public partner.

7.1 Causes of Reluctance of Private Partner towards Public Audit

In the foregoing arrangement the private partners do not have first-hand experience of audits by public sector auditors. SAIs have generally experienced that private partners are averse towards getting audited by the public auditors. During interviews with some of the private partners following reasons for being apprehensive with public auditor were narrated.

1. The private partner is already subjected to statutory auditor (by chartered accountant/audit firm) and an independent Engineer is usually appointed under the contract to oversee construction, operations, maintenance and management of project assets and activities. All the reports sent to the public partner are being verified and certified/attested by the auditors or the Engineer as the case may be. Furthermore, the public partner can have on spot inspections of assets and records as per PPP contract provisions. In view of such rigorous monitoring already in place role of public sector auditor would only burden the private partner without having any consequential value addition. However, instead of a direct audit of the private partner, the public auditor may obtain relevant record through the public partner should a particular information is deemed necessary for getting audit assurance.

2. Usually in PPP projects the private partner finances the project through a combination of equity and debt, operates and manages the project facility for a given concession period and, in return, the private partner gets the right to receive users’ fee, toll tax etc., during the concession period. In this way, the financial, operational and revenues risks are transferred to the private partner. The deliverables on both sides, that is, public and private partners, are determined by the PPP contract. Therefore, in the presence of other elaborated assurance and monitoring mechanisms, the public auditor should focus on the contract management efficiency of the public partner instead of directly auditing the private partner.

3. Public sector auditors have experience in auditing accounts and operations of government organizations. Working of a commercial organization is different from that
of a government organization. Furthermore, the PPP concept has its own peculiarities and the arrangement is relatively new in the arena. Before doing an audit it is critically important for the auditor to understand the PPP concept, arrangement and functioning of an SPV in general and specific to a project. This is because PPP’s are very innovative and one project structuring and arrangements can differ a lot from the other. Without having this comprehensive understanding there may arise issues on which the private partner and public auditors would have difference of opinion.

4. Government procedures are often cumbersome and time consuming. Private partner is not familiar with public sector auditing procedures and requirements, e.g., their audit procedures, process of preparing and finalizing audit reports, how audit objections are finally disposed and how long would it take for an audit report to get settled or what would be the consequences for the Project if operational efficiency is sacrificed for procedural red-tapism. All these factors make the private partner wary of interacting with the public auditor.

5. Orientation workshops for private partners about government audit’s legal basis, objectives, scope, audit procedures and processes may be arranged in order to enhance comfort level of the private partner and public auditors. This would provide an excellent opportunity to both the private partners as well as the SAI to interact, exchange ideas and understand each other better.

In Philippines, it has been suggested by the PPP management that the approach of public sector audit needs to align on following lines in order to be able to add value to PPP projects through public auditing:

1. PPP project management should be evaluated on the basis of overall public benefit and better quality of life and not on financial considerations alone.

2. Innovation and liberal view towards achieving project objectives should be considered rather than stringency and routine compliance requirements.

3. Funding through private partner should be excluded from the scope of public audit if the repayment and financing costs are not to be shared through public sources.
8 Challenges in PPP Auditing

With the passage of time, PPP arrangements are being increasingly employed by governments. However, delivery of public services through private sector under an established legal framework is a relatively recent phenomenon and, therefore, legal framework to regulate private sector’s involvement in financing and operating infrastructure facilities is not mature as yet. Besides, complex sharing of risks and responsibilities between public and private partners, involvement of private sector as financier and as key stakeholder for delivery of public goods, influences of international competitors on the success of projects, emerging consciousness regarding environmental impact of projects, etc. have presented a whole new set of challenges to the SAIs in fulfilling their role as public auditors. While exhaustive introspection is required by each SAI to identify such new challenges, an indicative description of the same is provided in the following.

8.1 Paradigm Shift in Auditing

Complexities in procurements and externalities related to PPPs, e.g., issues associated with private financing, commercial competence of the public partner, allowing the control of public assets to private partners, nascent regulatory framework, risk sharing between public and private partners and ensuring sustainable production of public goods at optimum prices etc. render PPP related audits more demanding than the other domains of public sector auditing. A systematic and in-depth understanding of the traits of PPP audit and the resulting paradigm shift are vital to the success of these audits. Some of the novelties in PPP auditing are enlisted below:

1. Auditors need to have capacity of assessing commercial expertise of the public partner in order to ensure that public interests have been adequately protected and that the public partner has not taken unreasonable risks.

2. There may be situations in which access rights to the relevant record of the partnership are denied to the auditor. Auditors must have clarity regarding which forum is to be used for the enforcing existing audit mandate and the modalities in case revisions in mandate are required. Besides, auditors need necessary interpersonal skills to emphasis his impartiality and objectivity in order to mitigate the apprehensions and fears of project management regarding public audit.

3. Benchmarking of optimum quality of goods and services produced by PPP projects is a difficult task as little experience and data is available on producing public goods through PPP arrangements. Auditors need to have research abilities to make comparisons of similar projects at national and international levels. If such comparison is not possible the auditor should have the capability of inferring optimum quality levels through evaluating long-term projects at regular intervals.
4. In order to generate an information repository of good and bad practices auditors need to focus on aspects of success and failures both. This will not only enhance auditors’ capacity but will also go a long way towards improving management practices and winning the cooperation of PPP project management.

5. PPP projects, by their very nature are somewhat risky and these risks are apportioned between the private and the public partners and both have interests in the success of the project, nevertheless there always are chance of failures because of uncontrollable factors. In cases of such failures, auditors need the ability to distinguish between the failures because of mismanagement and those because of factors not in the control of the management.

6. SAIs usually treat PPP arrangements as public projects where the interests of the government prevail over those of the private sector partners. Keeping in view the positive contribution of PPPs towards overall economy and public welfare, public sector auditors shall have to shift the focus to safeguarding the interests of public and private partners both in order to facilitate the long term success of PPP arrangements in their respective countries.

In view of the foregoing, there is a need to evaluate the impact of such factors on the traditional audit mindset in order to enable a paradigm shift in auditing.

8.2 Legal Issues

While conducting PPP audits SAIs may come across some legal issues which need to be addressed for effective auditing of the PPP arrangements. Such issues would mostly be country specific. For the sake of example some legal issues faced by some of the surveyed SAIs who attempted PPP audits are given in the following.

CHINA

Some of the rules contained in the existing Audit Law are inadequate to deal with the new environment for investment audit and this has led to legislative gaps and lack of regulation in auditing PPP projects.

The existing regulations on PPP audit show problems such as inconsistency and lack of binding effect. In March 2015, the General Office of State Council demanded heightened efforts to audit and monitor government-invested projects, SOE-invested project and other PPP projects in the Guidance for Introducing Innovative Investment Management Practices and Creating a Collaborative Regulatory Mechanism. In May 2015, the Regulations on Concessions for Infrastructure and Public Utilities issued by NDRC and other five ministerial departments stated that PPP projects in the form of concession should be audited by local audit agencies (county-level or higher). These requirements on auditing PPP projects (concessions etc.) are, at some point, inconsistent and unaligned with the Audit Law, making the implementation of the same difficult. These may also result in legal disputes.
The accounting and reporting systems for PPPs have yet to be improved. The formulation of accounting standards governing project accounting and reporting of PPPs is still under way. Consequently, the quality of information and the level of information disclosure are inadequate as regards fair presentation. All this results in unavailability of sufficient information required for auditing PPP projects.

**Pakistan**

Though there are elaborate laws providing a legal framework for undertaking PPP projects, there is no provision within the framework which provides for PPP audit by SAI Pakistan. Particularly, in cases of BOT modality, audit of the SPV is conducted by independent chartered accountants, appointed as statutory auditors as per the terms of contract. The private partners therefore resist audit of their accounts by SAI Pakistan. Audit by chartered accountant firms would not have been an issue for SAI Pakistan had there been no involvement of public funds or public assets. For the reason that, in one way or the other, public resources are employed in PPP projects, it becomes the responsibility of the AGP to ensure accountability over the use of public resources.

**Philippines**

Legal/statutory framework only provides for the contract review of the project. As a PPP project involves public money or assets, there should be elaborated provisions for auditing in order to protect public interests. Lack of understanding has been observed regarding the manner/process of undertaking different contractual arrangement under BOT Law. Conflict arises in the manner the law is interpreted vis-à-vis its application.

**Vietnam**

Legal framework and policies for PPP projects cover only the State and investors’ benefits. These policies do not govern the impacts of projects on environment and benefits to the users like cost of services being charged to the users. Therefore, these policies need to be improved to protect financial and environmental interests of users and residents of project areas.

8.3 **Capacity Issues**

PPP arrangements are complex in nature typically involving broad range of areas, huge investments, multiple stakeholders having varying sets of interest a long period of construction and/or service delivery, etc. Assumptions made at project inception are liable to change during the relatively long validity periods possibly having negative impact on project outcomes. Sharing of risks between the private and public partners is another highly technical and sensitive domain. Externalities like environmental and social impacts may also concern the general public.
Complexities associated with PPP arrangements require higher levels of knowledge and skills for auditors. Representing a new approach to project audit, PPP auditing relies on the insight into policy guidance, a wide set of skills and innovative approaches. As such, PPP auditors need to be equipped with expertise and skills like in finance, fiscal management and engineering. They need to have up-to-date knowledge in areas like project appraisal, budgeting and legal matters and state of art capabilities for comprehensive evaluation/auditing, analysis of big data and strategic analysis etc. Consequently, SAIs are facing the challenge of redefining the roles, duties and functions of auditors and set forth the knowledge and skills requirements for PPP audit.

8.4 Interaction with the Audit Entity

Relevant laws in surveyed SAIs do not explicitly provide for access to record with the private partner to the public auditor. PPP contracts provide for the audit from the commercial auditing firms, however, commercial auditors are not very familiar with the risks relating to public interests. Their audit objective is usually limited to attestation of the financial information of the project.

Therefore, public auditors cannot rely entirely on the report of the audit firms and may need additional information for some of their audit objectives. However, there has been a significant resistance from the private partner to provide access to its documents to the public auditor. The apprehensions and reluctance of the private partners are mainly due to the factors like, private sector is not familiar with the public auditing procedures and processes and that while private sector is likely to be more result oriented public auditors usually give more significance to observance of rules and procedures along with the results achieved, etc. Under such circumstances public auditors are left with the only choice of getting the record of private partner through public partner and if provision of such record is not covered under the PPP contract, the audit is unable to get assurance on related objectives.
9 Findings and Recommendations

9.1 Findings

1. In traditional public procurement the public sector pays for the construction or development of an asset and then makes separate arrangements for the continuing maintenance and operation of this asset while traditional outsourcing by public sector simply involves the provision of services. Traditional procurements and outsourcing involves public finances. However, PPPs have opened up new horizons of delivery by involving private sector’s finances, technologies and efficiencies. Being a newer mode of public procurement of assets and services, governments are only gradually becoming conscious of need of legal and regulatory frameworks to enter into PPP arrangements. As such, these legislative and regulatory frameworks are still in the stage of evolution and would need some time to get fully mature.

2. There are unlimited possibilities of PPP arrangements depending upon the output requirements, functions assigned to the private partners and mode of payments to them. In fact, variation in PPP arrangements is a continuum with umpteen possibilities of sharing resources, risks and profits/revenues between the public and private partner. Also, consistent international terminology for naming and describing these different types of contract has not yet evolved. Consequently, varying terminology tends to create confusion when comparing international experience.

3. It is not possible to associate certain types of PPP arrangements specifically to a particular sector. Although some PPP types may be more frequently used in a particular sector, the PPP types cannot be categorized in sector specific compartments. Rather, in each sector any kind of PPP arrangement can be made depending upon factors like availability of funds, assets, technology, management experience, etc. with the private partners along with presence of suitable environment that makes the private partner willing to participate in that sector.

4. Development of fit-for-all type of audit programs is not possible even for one particular type of PPP arrangement, rather the discipline of PPP audits would remain research intensive and continuously evolving as long as the PPP arrangements themselves keep on evolving. Although an indicative list of associated risks can be prepared for the guidance of auditors, each PPP audit assignment is bound to have its own detailed risk analysis in order to cover the risks to public interests exhaustively.

5. PPPs being non-traditional type of government operations, related legislations, rules and regulations have been developed subsequently only when the need is felt for such governing authorities and are still in the evolution phase. Explicit legislative provisions for auditing PPPs are missing in most of the countries. SAIs in these countries are drawing their mandates for PPP audits implicitly from the provisions that authorizes SAIs
for auditing wherever public officials, assets or funds are employed. However, this unclear mandate often results in conflict with the private partners who are reluctant to present their documents to public auditors. Likewise, authority of the overseeing legislative bodies, like PACs, to give recommendations/directions to the private partners is also not explicitly clear.

6. SAIs are not yet sufficiently experienced in the auditing of PPP arrangements and it would take several audit cycles before SAIs can become as proficient in this discipline as they are in their other audit activities. Nevertheless, SAIs have been attempting compliance and performance audits for PPP arrangements in order to gain assurance on the audit objectives that whether the interests of the public partner in the PPP arrangement have been safeguarded and that whether the PPP model has provided the best value for money.

7. Designated auditee of public auditor has generally been the public partner in the PPP arrangements. Private partners are averse towards getting audited by the public auditors because of factors like the operations and accounts of the private partner are already under scrutiny by the public partner and commercial auditors, private partners are not familiar with the processes of public auditing and consider it as unnecessary interference in their functions and that public auditors are not sensitive to the needs of project rather their focus is on mere compliance with applicable authorities which sometimes become hindrance against the efficient project management.

8. Factors like variety of PPP arrangements, highly complex contract conditions, absence of explicit mandate for auditing the record with the private partner, apprehensive and non-cooperative private partner and capacity and mindset issues with the public auditors, together pose a formidable challenge to SAIs to become the acceptable and effective auditors of the PPP arrangements.

9.2 Key Question and Goals

Based on aforementioned findings following key question is developed for making recommendations:

“How to create an enabling environment for SAIs to conduct effective audits of PPP arrangements in accordance with related INTOSAI Guidelines so that SAIs become partner in adding value to public procurement of assets and services through PPP arrangements?”

Following goals are identified in order to create such enabling environment as is envisaged in the Key Question:

GOAL 1: Ensuring adequate legislative and legal framework for carrying out public procurement under PPP arrangements and conducting their audits through public auditors.
GOAL 2: Capacity development of SAIs with respect to audits of PPP arrangements.

GOAL 3: Ensuring access to required PPP company’s records without estranging the private entrepreneurship.

9.3 Recommendations

GOAL 1:

SAIs need to inform the parliamentary committee for audits (PACs) or interact with the legislature through other appropriate forum to facilitate necessary legislation/directives to the executive in following regards:

1. Legislative, legal and regulatory frameworks for carrying out public procurements under PPP arrangements form the basic criteria for audits of PPPs. The more comprehensive these frameworks are the more meaningful and effective would the audit be. Therefore, SAIs need to evaluate whether the relevant frameworks are in place or not and if they are present whether these comprehensively cover all the aspects of PPP arrangements. The assessment of adequacy of these frameworks would be an ongoing activity for at least few audit cycles.

2. SAIs need to have clear and explicit mandate to audit all kinds of PPP arrangements in order to get full cooperation from the PPP project management.

3. Recommendations/directives of the parliamentary committees attending to audit reports (PACs) should be binding upon the PPP project management as a whole and private partner should be no exception.

GOAL 2:

PPP arrangements are characterized by complex factors like assessing suitability of the private participants, multiple stakeholders pursuing conflicting interests, risk sharing arrangements, quality management of the output, huge contingent liabilities to the Government, etc. As such, audit of PPPs require much more capacity building on part of auditors. Following are the recommendations in this regard:

4. SAIs may establish the requirements of knowledge and skills required by the public auditors for carrying out PPP audits. Examination of risks in the ongoing PPP projects and past experience of PPP audits can be helpful in coming up with a suitable list of such capacity requirements. SAIs may also identify as to which expertise/specialist skills are to be outsourced keeping in view the cost effectiveness considerations.

5. Where possible, SAIs may establish a dedicated PPP audit directorate or cell. This is necessary for having focused approach towards PPP audits, ease of capacity building, uniformity in audit practices and building a PPP audit information repository.

6. Training need assessments be made for the PPP audit directorate and specifically tailored training courses be designed for audit of PPP arrangements. There should be an
arrangement of modifying/updating the training modules continually as the SAIs progress on learning curve through their experience of field auditing of PPPs. To begin with, the training course should focus, inter alia, on the following:

a) development strategy and objectives of different tiers of government;
b) PPP concepts, objectives and legal framework;
c) PPP project planning, appraisal and approval processes;
d) risk sharing between public and private partners, PPP modalities and financial models used in PPP projects;
e) procurement and negotiation for PPP agreements;
f) monitoring mechanism to protect government’s interest during project implementation and operation;
g) value for money evaluations for PPPs;
h) related INTOSAI Guidelines; and
i) risks that auditor may focus at different stages of PPP project.

7. SAI may make arrangements to establish information repositories regarding PPP arrangements and these may be continually updated. Besides, arrangements may also be made to document and analyze the lessons learnt while conducting PPP audits and as a result of audit follow-ups. In this regard, experience in implementing related INTOSAI Guidelines may be given prime importance and logs be maintained where SAIs felt the need for modification in these guidelines. To this end, SAIs may collaborate with one another and share their knowledge and improvements made in PPP auditing practices. Online collaboration rooms may be used for such information and experience sharing.

**GOAL 3:**

In PPP arrangements, private sector finance and entrepreneurship are, at least, as much beneficial to the public sector as is the public sector resources for the private sector. Normally, a PPP company is under scrutiny through audit firms as external auditors, independent engineering consultants and various reports to be given to the public partner. Role of public auditor in this arena is to help improving the overall PPP program governance with the perspective of public interests and overall economic development. However, while making the public audit more effective as regards PPP arrangements care should be taken that the private partners do not shy away from such arrangements considering public audit as an over-scrutiny and hindrance to management efficiency. In order to avoid such a happening a shift in traditional audit paradigm is required.

In case of PPP audits, the public audit should be designed and coordinated in a way that it does not give the impression of being responsible for simply introducing delays or saddling PPP programs with requirements that are not appropriate for the specific needs of PPP. Whereas capacity building of SAIs in this regard would go a long way towards this
required paradigm shift, following is further recommended in order to enhance the trust and confidence of PPP company on public audit:

8. For orientation and understanding of the private partners about government audits, SAIs in coordination with the executing public agency may develop brochure / booklets on:
   a) Audit mandate of the SAI and its role and responsibilities in ensuring accountability regarding use of public resources.
   b) Government audit procedures starting from audit planning through to the exit meeting at the close of audit, presentation of audit report in the parliament and process of its final disposal.

9. The PPP audit directorate of the SAI, PPP authorities/implementing agencies and PPP company may arrange general orientation meetings or project specific workshops, in case of projects having significant financial outlay or socio-economic impacts. The dates and frequency of such workshops may be determined through mutual consultation. The agenda of the meetings / workshops may also be determined in advance through mutual consultation.

10. Before the commencement of PPP audit, the audit team may hold discussion with the concerned implementing agency in order to take them aboard on matters like:
   a. audit scope & objectives, audit methodologies and duration of audit assignment;
   b. record & documents required by audit team, especially from private partner / SPV; and
   c. locations & offices to be visited during audit execution.

   Any disagreement at this stage may be referred to the next higher level on each side for resolution of the disagreement. Such consultations between the two sides be held to clarify beforehand the expectations from each party. In this regard, the initiative would have to be taken by the public auditors to contact the executive authorities/PPP management to get the issues resolved.

11. Since the objectives of the public auditors are in consonance with the objectives of the public partner/ implementation agency, the relevant auditable record shall be available with the public partner if the contract has been correctly designed. If the case is not so the foremost focus of the audit should be on the adequacy of monitoring and supervision mechanism of the implementing agency. Recommendations of the audit in this regard should ensure that such deficiencies are not repeated in future PPP contracts. When it becomes necessary for the public auditor to have access to the information exclusively held by the private partner, the public auditor should make all efforts to coordinate through the public partner and take the private partner into
confidence regarding relevance of the requisite information with the agreed upon audit objectives. Legal means of conflict resolution may be considered as the last resort.
Appendix

SAIs' Individual Reports
1. CHINA

List of Acronyms

CNAO  National Audit Office of the People’s Republic of China
CPC    Communist Party of China
MOF    Ministry of Finance
NDRC   National Development and Reform Commission
BOO    Build-Own-Transfer
BOT    Build-Operate-Transfer
NHFPCN National Health and Family Planning Commission
NPC    National People’s Congress
PPP    Public Private Partnership
SOE    State-Owned Enterprise
SPV    Special Purpose Vehicle
DBFOT  Design-Build-Finance-Operate-Transfer
BLOT   Build-Lease-Operate-Transfer
VGF    Viability Gap Funding

1. The legal framework for PPPs

1.1 Laws and regulations on PPPs

Public-private partnership (PPP) as an emerging form of financing and managing projects has been strongly encouraged and promoted in China. China has released its policy guidance on the use of PPP arrangements. In May 2010, the Guidelines for Encouraging and Guiding the Robust Development of Private Finance announced by the State Council served as the prelude to the PPP-fueled investment boom. In November 2013, the Decision of the Central Committee of the Communist Party of China on Some Major Issues Concerning Comprehensively Deepening the Reform was adopted at the Third Plenary Session of the 18th Central Committee of the Communist Party of China, highlighting the decisive role of the market in the way resources are allocated and “allowing social capital to be involved in financing and operating urban infrastructure projects under special franchises”. Since then, the central government has adapted its measures and policies to find a way out of the dilemma of addressing the urgent needs for infrastructure amidst capital constraints in the public sector. As a result, governments at all levels started to make greater use of various PPP arrangements. The central and local governments have launched their PPP policies and programs. The State Council, Ministry of Finance (MOF) and National Development and Reform Commission (NDRC) have issued a series of framework directives on government regulations, policies, standard contracts and demonstration projects. Meanwhile, PPP demonstration projects have been found in many sectors including municipal utilities, transportation and healthcare and seen remarkable results.

Table 1 Chinese laws and regulations on PPPs

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<thead>
<tr>
<th>Authority</th>
<th>Directive</th>
<th>Date</th>
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<tr>
<td>Part one: General guidelines</td>
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<tr>
<td>Organization</td>
<td>Document</td>
<td>Date of Adoption/Announcement</td>
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<tr>
<td>NPC</td>
<td>The Contract Law of the People’s Republic of China</td>
<td>Adopted on Mar 15, 1999</td>
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<tr>
<td>NPC Standing Committee</td>
<td>The Government Procurement Law of the People’s Republic of China</td>
<td>Adopted on June 29, 2002</td>
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**Part Two: Regulations on PPPs**

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<tr>
<th>Organization</th>
<th>Document</th>
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<tr>
<td>General Office of the State Council</td>
<td>Guidelines for the procurement of services from the private sector on behalf of government agencies (GBF [2013] No. 96)</td>
<td>Sep 26, 2013</td>
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<tr>
<td>State Council</td>
<td>Guidelines for innovative investment and financing mechanisms involving private finance in key areas (GF [2014] No.60)</td>
<td>Nov 16, 2014</td>
<td></td>
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<tr>
<td>MOF</td>
<td>Notice on issues concerning the use of PPP models (CJ [2014] No.76)</td>
<td>Sep 23, 2014</td>
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<tr>
<td>MOF</td>
<td>Notice on issues concerning the implementation of PPP demonstration projects (CJ [2014] No.112)</td>
<td>Nov 30, 2014</td>
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<tr>
<td>MOF</td>
<td>Operational guidelines for PPPs (provisional) (CJ [2014] No.113)</td>
<td>Nov 29, 2014</td>
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The Ministry of Finance has called for taking structural, supply-side reform forward in the public service sectors with greater use of PPP arrangements to boost the quality and efficiency of public services and sustain growth momentum. On October 11, 2016, the Ministry of Finance announced its decision to promote PPPs in the public service sectors, stressing the need to step up PPP-related efforts and implement the “mandatory” demonstration projects in the central government-supported public service sectors. According to the decision, in the well-funded and market-driven public service sectors such as waste disposal and sewage treatment where PPP arrangements are more common and sophisticated, PPP should be the standard practice to develop a new project and the central government will cut back or stop subsidies for such projects. In other central government-funded public service sectors, assessment of PPP readiness is mandatory for the well-funded and eligible projects to encourage the use of PPP arrangements and improve the quality and efficiency of public services.

In accordance with the rules and regulations announced by the State Council and ministerial departments, the provincial guidelines, measures and programs for promoting PPPs have been announced in Beijing, Shanghai, Zhejiang, Jiangsu, Hunan, Qinghai and Anhui etc. In October 2014, NHFPCBeijing (National Health and Family Planning Commission of Beijing) stated clearly in its guidance for promoting the healthcare industry that “public hospitals are allowed to work with social capital under special franchises when the requirements for asset security, quality and safety in patient care and management capability have been met”.

1.2 Specific requirements on PPPs

These policies and guidelines have provided guidance for promoting PPPs, forging close cooperation between public and private sectors and improving the quality and efficiency of public services.

1.2.1 The concept of social capital in PPPs
The concept of private capital also known as “social capital” in China, was defined in the No.113 and No.156 Directives announced by the Ministry of Finance in 2014. According to the No.113 Directive, social capital refers to ‘domestic and foreign legal entities with a modern corporate governance system, except those government-owned financing platforms and the state-owned enterprises in the control of such financing platforms’. The No.156 Directive further clarifies that social capital refers to business entities that are duly incorporated and validly existing with an independent legal personality, including private, state-owned, foreign and foreign-invested companies, with the exception of government-owned financing platforms and the state-owned enterprises in their control (unless such state-owned enterprises are listed companies) that are not allowed to participate in the PPPs rolled out in the community where these companies are based.

A project company as a legal entity independently formed and managed can be funded by social capital (a company or a consortium) or jointly funded by social capital and government capital, whereas in the latter case, the government should hold a stake below 50% and stay out of the control and management of such project company.

1.2.2 The use of PPPs in various sectors

The use of PPPs was defined in MOF’s No.113 Directive announced in 2014. On the one hand, PPPs are recommended to be used in delivering public infrastructure and service projects that involve large volumes of investment, long-term needs, flexible pricing mechanisms and a highly developed market. On the other hand, PPP financial readiness in terms of value for money and fiscal affordability should be assessed by the finance department (PPP Center) beforehand; when a PPP is identified as financially sound, the project owner will file for approval; otherwise, necessary adjustments will be made to the action plans for reassessment; PPP arrangements with poor assessment results will be rejected.

The State Council’s [2015] No.42 Directive stressed the strategic importance of PPPs and suggested PPPs be used extensively in the provision of public services such as energy, transportation, water conservancy, environmental protection, agriculture, forestry, science and technology, affordable housing projects, medical care, health, pension, education and culture.

1.2.3 Roles and functions of the public and private partners in PPPs

The roles and functions of the government as defined in the State Council’s [2015] No.42 Directive:

a. Creating a robust financial management framework. Fiscal affordability will be reviewed to identify and keep project expenditures under control and ensure long-term fiscal sustainability. A holistic approach to cost management and accounting and innovative mechanisms for resources consolidation will be put in place to address a mix of funding methods, i.e. government-pay, user-pay and Viability Gap Funding and manage subsidies, fee structures and other considerations etc. under a centralized accounting system. The financial factors will be reviewed in the annual budget and medium-term financial plan and included in the government financial report. For existing public service projects, during their
transition to PPPs, appraisals of assets are required to identify their value and prevent the loss and unauthorized disposal of publicly owned assets. The revenues generated by public investment and the government’s share in excess earnings should turn over to the National Treasury directly.

b. Providing a multi-tier monitoring system. PPPs can be sponsored by a public sector authority under its economic and social development plans / programs, or initiated by a private sector entity to meet the socioeconomic needs of the local community. The public sector authority will provide industry-specific technical specifications and regulations on public goods and services and monitor the quality and prices of such public goods and services. A comprehensive evaluation system involving the government and general public as well should be developed, with a performance management mechanism covering the project life cycle, including identification of performance targets, performance tracking and performance review. The government-pay and user-pay practices will be subject to performance review and the results will be deemed an importance basis for price adjustment to maximize the public benefits. Disclosure of project information is required to ensure transparency and respond to public scrutiny.

c. Highlighting the guiding role of government investment and optimizing the use of government funds. Government investment generally goes to public goods and infrastructure construction. The government will provide financial support to the key areas where the participation of social capital is encouraged, such as environmental protection, agriculture, forestry, water conservancy, municipal utilities and social programs etc., playing a guiding role in the joint endeavors and making best use of the government funds available. If all else is equal, priority will be given to PPPs and the government will provide financial support in various forms, i.e. investment aid, injection of fund, subsidies and subsidized loans etc.

The MOF [2014] No.76 Directive described the financial responsibility of PPPs regarding budgeting, government procurement, government debt management and fiscal expenditure performance analysis throughout the process from identification of funding resources and partners, granting subsidies to delivering public services. Governments will be responsible for fiscal management, which involves project assessment, choosing the right partner, formulating PPP contracts. Meanwhile, governments should oversee the management of public subsidies, improve the mechanism for public risk management and conduct performance reviews.

The MOF [2014] No.112 Directive urged fiscal authorities at all levels to perform their functions in fiscal management and work out a mechanism for the efficient and effective coordination with other regulators to facilitate the implementation of PPPs.

The MOF [2014] No.156 Directive specified the functions and responsibilities of the government as a “public affairs administrator” and/or “public goods and services buyer or buyer’s agent” as well as the relationship between the government and the project company (or social capital). As a public affairs administrator, it’s the government’s job to deliver high-quality, affordable public goods and services to the general public. In doing so, the government is responsible for planning, public procurement, management and monitoring of PPPs while building an administrative relationship with the project company.
(or social capital); as a public goods or services buyer (or buyer’s agent), the government maintains a contractual relationship with the project company (or social capital) and performs its rights and obligations under the PPP contracts.

The MOF[2016] No.92 Directive urged fiscal authorities at all levels to work with the relevant authorities to harmonize and mobilize public assets and resources including fiscal funds and state-owned assets and participate in PPPs on an equal and mutually beneficial basis. Meanwhile, these government agencies should perform their duties in relation to identification and assessment of PPP projects, government procurement, budgeting and performance management, balance sheet management, information disclosure and monitoring etc. to ensure the efficient project implementation through the PPP life cycle.

1.2.4 Risk allocation principles

The MOF [2014] No.156 Directive described the purpose of PPP contracts as the allocation of risk between the government and the project company by setting out the rights and obligations of the parties thereto in a bid to facilitate the implementation of and ensure value for money for PPPs. PPP contracts should be formulated accordingly, embodying the following basic risk-sharing principles:

- a. Risks should be allocated to the party who is best equipped to manage them.
- b. Such party can reasonably transfer the risks (for example, through insurance coverage).
- c. Such party has a greater interest or motivation for keeping the risks under control.
- d. Such party can mitigate the risks in the most cost effective way.
- e. When the risks materialize, such party should not shift the resulting costs and losses to the other party (parties) involved.

The Directive further suggested that the allocation of risk in PPPs should be negotiated individually. In practice, the risk allocation arrangements vary remarkably from case to case.

1.2.5 PPP contract management

Common clauses and mechanisms in PPP contracts.

1.2.5.1 The parties to a PPP contract

A PPP contract is usually entered into by and between the following parties:

- a. The public sector partner: The public sector partner is the contracting party (party to the PPP contract) on behalf of the government side. In China, a public sector partner is usually the local government or a public sector authority duly authorized to act on behalf of the local government. For example, a provincial-level PPP highway project will be signed by the local transport department.
b. The project company: The project company is a special company formed to implement the PPP project. It can be a domestic or foreign-invested enterprise, depending on the nationality of its shareholders.

1.2.5.2. Main terms and conditions

PPP contracts vary widely by sector, payment terms and form of operation. Generally, the core clauses in a PPP contract are as follows: Introduction, definition and interpretation; scope and term; prerequisites; project financing; project land; project construction; project operation; ongoing project maintenance; restrictions on changes in ownership; payment mechanism; performance guarantees; government commitment; insurance; regulatory compliance and change in law; force majeure; government intervention and supervision; breach of contract, early termination and post-contract management; handover of project; governing law and dispute resolution; annexes and exhibits etc.

In addition to the above core provisions, a PPP contract contains clauses commonly found in a general purpose agreement, such as copyright and intellectual property, environmental protection, representations and warranties, notices, severability and revision clauses.

1.2.6 Disclosure of project information

The Guidelines for the Management of Information Disclosure through PPP Information Sharing Platform (provisional) (CJ [2017] No.1), with effect from March 1, 2017, were developed to address the disclosure of project information in all PPPs through China’s PPP information sharing platform, specifying the project information to be disclosed at different project stages, i.e. project identification, preparatory work, procurement, implementation and handover.

These guidelines call for heightened scrutiny and set forth the following requirements:

a. MOF will be in charge of evaluation and monitoring of information disclosure in PPPs across the country; the provincial-level fiscal authorities will oversee information disclosure in local PPP projects. Information on PPPs should be authentic, complete and accurate and should be collected in a timely manner. Failure to do so will subject the reporting authority to corrective measures, and even public reprimand.

b. The public sector authority, project operator, social capital or project company involved in a PPP project should be responsible for the authenticity, completeness, accuracy and timeliness of information made available by them respectively.

c. Abuse of power, negligence and other types of malpractice identified in the process of monitoring the disclosure of PPP project information will be investigated under the Civil Service Law, Administrative Supervision Law and Regulation on Penalties and Sanctions against Illegal Fiscal Acts. Alleged crimes will be referred to judicial authorities.

2. Scope of PPPs and available options

As part of the supply-side structural reform, PPPs have gained traction in China. The first PPP demonstration projects were launched in 2014. Since then, PPP arrangements have
been introduced into more and more provinces and sectors over the past three years as a strong driver of investment. MOF has so far announced 743 demonstration projects with total investment estimated at approx. RMB 1.86 trillion. Spanning 19 sectors, these projects are located in 34 provinces and municipalities. The state authorities and local governments in China have developed the policy guidance for tracking, coordinating and regulating PPPs to ensure a lifecycle approach to project management.

2.1 The boom of PPPs in China

As at the end of December 2016, there are 743 demonstration projects in China, with the total investment estimated at RMB 1.86 trillion. In particular, 22 projects (originally 30 projects, with 6 projects already removed and 2 to be removed from this batch) were launched in 2014 with total investment amounting to RMB 70.9 billion; 205 projects (originally 206 projects, with 1 project already removed from this batch) were rolled out in 2015 with total investment up to RMB 626.7 billion; 516 projects were announced in 2016 with investment totaling RMB 1.17 trillion. A PPP project evolves over five stages through its life cycle, i.e. identification, preparatory work, procurement, implementation and handover. The project success rate refers to the ratio of the sum of projects in the implementation and handover stages to the sum of projects in the preparatory work, procurement, implementation and handover stages. So far, 363 projects have been successfully signed with a project success rate of 49.7 per cent at the end of December 2016. In particular, the project success rate is 100 per cent (22 projects) for 2014, 62.4 per cent (121 projects) for 2015 and 42.9 per cent (220 projects) for 2016 respectively. China PPP Center research shows that these demonstration projects serve as a bridge between “capital shortage” and “asset shortage” in addressing problems such as access to financial resources, financing costs and maturity mismatch etc.

2.1.1 Expansion of demonstration projects

The first batch of PPP projects were launched in 11 provinces, covering 4 sectors; the second batch in 28 provinces, covering 16 sectors; the third batch in 30 provinces, covering 18 sectors. The project library spans 19 sectors including energy, transport, water conservancy, environmental protection, municipal engineering, urban development, agriculture, forestry, science and technology, affordable housing, tourism, healthcare, senior care services, education, culture, sports, social security and infrastructure. Among the 363 successfully implemented demonstration projects, there are 180 municipal projects, accounting for 50 per cent of all PPPs and staying ahead since May; 37 transport projects or 10 per cent; 30 environmental protection projects or 8 per cent; 21 water conservancy projects or 6 per cent; 36 education, healthcare and senior care projects or 10 per cent.

2.1.2 Top sectors: Municipal engineering, transport and urban development

As at the end of December 2016, the project library has collected information of 11,260 projects with total investment up to RMB 13.5 trillion. In particular, there are 6,987 projects at the identification stage, with investment estimated at RMB 6.7 trillion; 1,936 projects at the preparatory stage, with investment estimated at RMB 3 trillion; 986 projects at the procurement stage, with investment estimated at RMB 1.5 trillion; 1,351 projects successfully implemented, with investment estimated at RMB 2.2 trillion; none of these
projects has entered into the handover stage. Specifically, municipal engineering, transport and urban development are the top 3 sectors in terms of the number of PPPs and size of investment, accounting for 54 per cent of the total number and 68 per cent of the total investment. Municipal engineering, transport, tourism and urban development are seeing a large number of new projects; there is a substantial increase in investment in transport, municipal engineering, urban development and tourism.

2.1.3 A trend towards government-pay and VGF schemes

As at the end of December 2016, in respect to three ROI mechanisms, there are 4,687 user-pay projects, with investment estimated at RMB 4.6 trillion, accounting for 42 per cent of the total number and 34 per cent of the total investment respectively; 3,591 government-pay projects, with investment estimated at RMB 3.37 trillion, accounting for 32 per cent of the total number and 25 per cent of the total investment; 2,982 VGF projects, with investment estimated at RMB 5.52 trillion, accounting for 26 per cent of the total number and 41 per cent of the total investment. In 2016, government-pay and VGF schemes together saw a rising share to approx. 60 per cent while user-pay projects were down to about 40 per cent.

2.2 Regulations on PPP arrangements

As pointed out in the MOF [2014] No.76 Directive, the technical standards, management requirements and expertise required for PPPs vary widely from sector to sector, resulting in the different forms of project delivery.

Under the NDRC Guidance on PPPs, based on whether or not the projects generate revenues and whether or not the investment can be recouped, PPPs are grouped into three categories and the available options are analyzed.

a. Operating schemes. For fee-based PPPs where the investment costs are recoverable, the government will grant concessions and such projects will be proceeded with under a Build-Operate-Transfer (BOT) or Build-Own-Operate-Transfer (BOOT) contract. The construction and operation markets should be open to the private sector partners to promote franchising / concession granting in natural monopolies.

b. Quasi-operating schemes. For PPPs where the investment costs are unlikely to be recovered with operating revenues and funds/resources from the government partner are required, the government will grant concessions and provide a capital subsidy / direct investment. Such PPPs will be proceeded with under a Build-Operate-Transfer (BOT) or Build-Own-Operate (BOO) contract. A well-structured mechanism coordinating investment, subsidy and price should be developed to enable a reasonable return on investment.

c. Non-operating schemes. For PPPs based on “government pay” rather than “user pay”, the government will purchase the services and such projects will be proceeded with under a Build-Own-Operate (BOO) or service contract. The scope of purchase should be reasonably identified to make best use of the funds available.

The State Council [2015] No.42 Directive stressed the need to promote PPPs in an orderly manner and set forth how PPP options should be selected to meet the different needs in a variety of sectors.
a. Concessions may be granted under the Regulations on Concessions for Infrastructure and Public Utilities in certain sectors such as energy, transport, water conservancy, environmental protection and municipal engineering etc.

b. Transfer-Operate-Transfer (TOT) and Rehabilitate -Operate-Transfer (ROT) contracts may be used to transform the existing public service projects into PPPs by bringing social capital on board for rehabilitation and operation. With the consent of the creditors, the government debt will be converted into non-government debt to ease the debt burden of local governments and refocus their financial resources on public works.

c. A streamlined decision-making process should be adopted to ensure fully informed decisions on new projects. Local governments will assess the economic and social benefits of such projects as well as their fiscal affordability, taking into account the needs of local community and the fiscal balance considerations. Available options include Build-Operate-Transfer (BOT), Build-Own-Operate (BOO) etc., depending on a range of factors such as project cycle, pricing mechanism, ROI, risk allocation framework and government involvement.

2.3 Existing PPP options

From the perspective of PPPs being implemented in China, it’s clear that local governments are seeking the suitable PPP options in delivering public or infrastructure services, based on a comprehensive analysis of industrial features, existing project or new project, role of private sector partner(s) and payment mechanism etc. Here’s an overview of PPP options for municipal engineering, transport and healthcare. The financing arrangements for PPPs are much more complicated than the general types of financing.

2.3.1 Municipal engineering

The analysis of PPPs in municipal engineering uses water services as an example. Public water utilities are of great significance to the sustainable development of a city. In recent years, with the rapid increase in population, there is a greater demand for water infrastructure. PPPs have long been found in this area, usually in the form of management contracts, lease contracts or concessions under BOT or TOT arrangements.

The Luoma Lake Water Source and Raw Water Pipeline PPP in Xuzhou, one of the MOF’s first demonstration projects, is a RMB 2.4-billion water supply project. Through a competitive tendering process, Guangdong Holdings Limited, a conglomerate duly authorized by the government of Guangdong to operate state-owned assets, was awarded the contract. A project company was then set up by Guangdong Holdings Limited and New Water Corp. (the government partner). In line with the central government’s policy guidance on PPPs, a Transfer-Operate-Transfer (TOT) arrangement was used, which involved the transfer of project assets and project operations from the local government to the project company. The project company is responsible for the operation and maintenance of the urban raw water project within the concession period and will transfer all project assets back to the local government or the new project company when such concession expires.

The local water company is the recipient of the services delivered under the project contract.
The long-standing differences over water price between the water company and the local government have a direct impact on the price of raw water, resulting in an arrangement that the payment for the raw water will be settled between the local government and the water company to ensure the economic benefits for the social capital investment. It’s estimated that the use of PPP will help reduce an initial subsidy from RMB 200 million+ to less than RMB 100 million, smoothing out the fiscal spending and ease the current fiscal burden. Under the PPP contract, raw water supply capabilities will be remarkably improved to avoid problems such as low efficiency, institutional bloat and high costs that are common when the project is operated by the government itself.

2.3.2 Transport

The transport sector is a natural monopoly and transport projects are characterized by high initial costs, a time consuming process and complicated contracts. As a result, many PPPs in the transport sector are implemented in the form of BOT. In the case of the Beijing Subway Line 4, as the first successful PPP-financed urban rail transport project in mainland China, it has set a good example for the use of PPPs for financing and project management in building a regional transport integration system covering Beijing, Tianjin and Hebei. Attracting up to RMB 15.3 billion in total investment, the Beijing Subway Line 4 project was divided into two parts, i.e. Part A and Part B. Part A, mainly civil works and tunnels, received RMB 10.7 billion from the government of Beijing; Part B, mainly mechanical and electrical equipment and trains, received RMB 4.6 billion from Beijing MTR Co., Ltd., the special purpose vehicle (project company) formed under a PPP arrangement to finance, build and operate this project. Beijing Capital Group, Beijing Infrastructure Investment Co., Ltd. and MTR Corp. own 49 per cent, 2 per cent and 49 per cent of Beijing MTR respectively. Adopting a compensation mechanism based on passenger trips and ticket fares, this PPP scheme will be managed by the project company over a concession period of 30 years before the final handover. If all else is equal, the PPP scheme has helped reduce the cost of investment by RMB 9.88 billion for the Beijing Subway Line 4 project, as compared with conventional financing.

2.3.3 Healthcare

The complicated nature of health infrastructure and health services makes concessions the preferred form for PPPs in the healthcare sector, usually under PFI or IOT arrangements.

Under the PPP agreement among CR Phoenix, State Administration of Work Safety (SAWS) and CITIC Trust, Zhong An Kang Health Investment (Beijing) Co., Ltd. was formed, with the three parties owning 35 per cent, 40 per cent and 25 per cent of the SPV. SAWS invested in the SPV through China Meitan General Hospital (90 per cent of the hospital assets); CR Phoenix and CITIC Trust paid their contributions into the SPV in cash. During the initial stages of this PPP project, Zhong An Kang implemented an asset restructuring program involving two SAWS hospitals, i.e. China Meitan General Hospital and Shilong Hospital, and worked with these hospitals under a Restructure-Operate-Transfer (ROT) arrangement. CR Phoenix also manages ten general hospitals under Investment-Operate-Transfer (IOT) contracts. In September 2014, an IOT agreement regarding the management of the local maternal and child health hospital was entered into between CR Phoenix and the government of Mentougou, Beijing.
<table>
<thead>
<tr>
<th>Demo Projects</th>
<th>MOF Projects</th>
<th>Key information</th>
<th>Total investment</th>
<th>Term of agreement</th>
<th>Sector</th>
<th>PPP arrangement</th>
<th>Payback mechanism</th>
<th>Date of contract</th>
<th>Social capital</th>
<th>Project company</th>
</tr>
</thead>
<tbody>
<tr>
<td>Utility Tunnel Project in Liupanshui, Guizhou</td>
<td>Zhelin Lake Conservation Project in Jiujiang, Jiangxi</td>
<td>Dawulan-Lengkou (Qintangjie) Highway Project in Heibei</td>
<td>Yingyang People’s Hospital PPP Project in Henan</td>
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<tr>
<td><strong>Total investment</strong></td>
<td>RMB 2994 million</td>
<td>RMB 1320 million</td>
<td>RMB 3298 million</td>
<td>RMB 640 million</td>
<td></td>
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<tr>
<td><strong>Term of agreement</strong></td>
<td>30 years</td>
<td>17 years</td>
<td>327 months (construction - 30 months; operation – 297 months)</td>
<td>12 years</td>
<td></td>
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<tr>
<td><strong>Sector</strong></td>
<td>Municipal engineering: Utility Tunnel</td>
<td>Conservation and environmental protection</td>
<td>Transport</td>
<td>Healthcare: Hospital</td>
<td></td>
<td></td>
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<tr>
<td><strong>PPP arrangement</strong></td>
<td>BOT</td>
<td>DBFOT (Design-Build-Finance-Operate-Transfer)</td>
<td>BOT</td>
<td>BLOT (Build-Lease-Operate-Transfer)</td>
<td></td>
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<td></td>
</tr>
<tr>
<td><strong>Payback mechanism</strong></td>
<td>VGF</td>
<td>Government-pay</td>
<td>User-pay</td>
<td>Government-pay</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Social capital</strong></td>
<td>China State Construction Engineering Corporation</td>
<td>Xingyuan Environment</td>
<td>Consortium: Hengtai Caofeidian Energy Co., Ltd., CCCC First Highway Engineering Co., Ltd.</td>
<td>China Construction Seventh Engineering Division</td>
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</table>
### 2.4 The relation between PPPs and socioeconomic development

The Chinese economy is at an exceptional time characterized by economic adjustment combined with restructuring efforts and aftershocks of earlier incentives. PPPs have proved to be an important approach to transforming government functions, addressing financial stress and improving public services amidst the “new normal”.

Promoting the use of PPPs is part of efforts to bolster the process of urbanization in China. China's urbanization rate is expected to reach 60 per cent by 2020, and the investment required for economic and social infrastructure is about RMB 42 trillion. By 2020, China's urban rail transit mileage will reach 10,000 km, with total investment estimated at about 5 trillion. PPPs can be used to address effectively the needs for funds in the process of urbanization by broadening access to capital and creating a diversified and sustainable funding mechanism.

Promoting the use of PPPs is an important measure to improve the delivery of public services by governments. One of the objectives for deepening the reform identified during the Third Plenary Session of the 18th CPC Central Committee is to modernize the governance system and capabilities of the Chinese government. The shift from administration to governance represents a major theoretical innovation focusing on the healthy interaction among the government, market and society and defining clearly their roles and responsibilities. Promoting the use of PPPs is an institutional change aimed at
speeding up the transformation of government functions and the improvement of governance capabilities. The PPP approach brings together the strategic planning, market oversight and delivery of public services by the government and the management efficiency and technological innovation in the private sector. All this helps understand the line between the government and the market and, in turn, raises awareness of the rule of law, the spirit of contract and the role of market in the process of performing public functions and delivering public services.

The use of PPPs is necessary for developing a modern fiscal system. Under China’s reform initiative for its fiscal and taxation system, it’s important for a modern fiscal system to adopt a multi-year budgeting approach, develop the medium-term fiscal plan and prepare the consolidated financial statements that fully reflect the state of the government’s balance sheets. PPP is by its nature a form of government procurement. It requires a shift from annually balanced budget to medium-to-long-term fiscal planning, which is highly consistent with the purpose and goal of deepening the fiscal and taxation reform.

3. Potential Risks of PPPs

3.1 Potential risks associated with PPP procedures

According to MOF’s guidelines, the PPP life cycle comprises five stages, i.e. project identification, preparatory work, procurement, implementation and handover. Each stage involves a distinct array of risks associated with the key activities taking place in such stage.

3.1.1 Potential risks associated with project identification

Activities taking place in the project identification stage include project initiation, project screening, value-for-money analysis and financial affordability assessment etc. Potential risks associated with these activities are as follows:

a. The requirements for entering into the PPP arrangement are not met.

b. The private sector entity is not eligible.

c. The intended goal of the PPP arrangement cannot be accomplished, e.g. a local public sector partner is using the PPP project as a disguised financing arrangement.

d. The feasibility report, project deliverables checklist and preliminary implementation plan are not complete and accurate.

e. The fiscal authority fails to conduct the value-for-money analysis as required.

f. The present value of the proposed capital expenditure of the government over the project life cycle is not properly calculated in the quantitative evaluation conducted by the fiscal authority for the PPP project.

g. In the case of a government-pay or government-subsidized PPP project, financial affordability is not assessed.
h. The annual government payments or subsidies exceed the allowed proportion of government expenditure.

3.1.2 Potential risks associated with preparatory work

Activities taking place in the preparatory stage include design of management structure, preparation of implementation plan, and review of implementation plan etc. Potential risks associated with these activities are as follows:

a. The management structure of the PPP project is not properly designed.

b. The following problems are found in the project implementation plan prepared by the implementing agency:
   
i. Key economic and technical indicators are not correctly calculated;

   ii. Project risks are not allocated between the public and private partners on the principles for optimizing risk sharing, aligning risk and reward and keeping risks under control;

   iii. The government assumes risks that are supposed to remain with the private sector entity, including commercial risks associated with project design, construction, financial management, operation and maintenance etc.

   iv. The investment/financing structure and payback mechanisms fail to meet the policy requirements.

   v. Public responsibilities of the private partner, government-pay methods, allocation of risks, and pricing mechanisms are not clearly defined in the PPP contract.

3.1.3 Potential risks associated with procurement

Activities taking place in the procurement stage include prequalification, preparation of procurement documents, document review and contract signing etc. Potential risks associated with these activities are as follows:

a. The guidelines for bidding, tendering and open competition are not followed.

b. There are violations of the Government Procurement Law and applicable rules and regulations in the process of procurement.

c. The procurement method is not properly chosen to meet the needs of the PPP project.
3.1.4 Potential risks associated with implementation

Activities taking place in the implementation stage include the formation of project company, financing management, performance review and payment, and interim evaluation etc. Potential risks associated with these activities are as follows:

a. The private partner fails to provide funds in full or on time as agreed in the PPP contract to form the project company.

b. The project company is not effectively and efficiently managed.

c. There are construction delays and major changes in the construction and operation costs that are not allowed under the PPP contract.

d. The public partner’s payment obligations under the PPP contract are not included in the local government’s budget plan or performed in accordance with the regulations on budget management.

e. Government intervention becomes excessive.

f. Public funding is withheld, idled, used inefficiently or wasted.

g. The PPP project assets fail to meet the capacity or efficiency requirements or deliver the public services stated in the PPP contract.

h. The private partner or project company is found in violation of contract provisions, environment regulations or code of conduct, or is otherwise deemed to pose a threat to deliver the public goods and services in a consistent, stable and safe manner.

i. The public partner’s payment obligations under the PPP contract are not included in the government comprehensive financial report.

j. The public partner / private partner / project company fails to meet the requirements for mandatory information disclosure.

3.1.5 Potential risks associated with project handover

Activities taking place in the handover stage include pre-handover preparation, performance testing, transfer of assets and performance evaluation etc. Potential risks associated with these activities are as follows:

a. The handover criteria (e.g. availability of equipment, min. service life etc.) are not specified in the PPP contract;

b. The project fails to meet the handover criteria;

c. The asset appraisal and performance testing plans are not thorough, e.g. excessive compensation.
After the project handover is completed, the fiscal authority fails to arrange a performance review of project deliverables, cost efficiency, regulatory effectiveness and sustainability etc.

### 3.2 Risks associated with stakeholders and project environment

The key risks associated with stakeholders and projects environment in PPPs are shown in Table 3.

<table>
<thead>
<tr>
<th>Type</th>
<th>Potential risks</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Stakeholders</strong></td>
<td></td>
</tr>
<tr>
<td>Public partner</td>
<td>Lack of informed decision-making, corruption, lack of execution, excessive intervention, inadequate funding, lack of PPP information disclosure in financial statements, irrational risk sharing issues etc.</td>
</tr>
<tr>
<td>Private partner</td>
<td>Inadequate funding, slow progress in construction, noncompliance with contract provisions etc.</td>
</tr>
<tr>
<td>Project company</td>
<td>Poorly designed implementation plan, inadequate governance structure, poor construction techniques, noncompliance with technical specifications, cost/quality/construction time out of control, uncoordinated management, engineering changes, late delivery of supplies, poor quality of supplies, lack of expertise and experience for construction/operation/maintenance etc.</td>
</tr>
<tr>
<td>Experts/consultants</td>
<td>Lack of competence, lack of independence, wrong evaluation methods etc.</td>
</tr>
<tr>
<td>The general public</td>
<td>Low satisfaction with project features, unawareness of project purpose, disagreement with compensation, misuse etc.</td>
</tr>
<tr>
<td>Regulators</td>
<td>Poorly designed monitoring procedures, collusion in corruption etc.</td>
</tr>
<tr>
<td><strong>Project environment</strong></td>
<td></td>
</tr>
<tr>
<td>Natural environment</td>
<td>Poor geological conditions, climatic factors and other acts of god.</td>
</tr>
<tr>
<td>Economic environment</td>
<td>Volatilities in domestic and international markets, inflation etc.</td>
</tr>
<tr>
<td>Social environment</td>
<td>Regional cultural conflicts, terrorist incidents etc.</td>
</tr>
<tr>
<td>Policy environment</td>
<td>Lack of legislation, changes in economic policies, industrial restructuring, monetary tightening etc.</td>
</tr>
</tbody>
</table>
4. National Audit Office of People’s Republic of China: Duties and types of audit

4.1 Statutory duties of National Audit Office

National audit laws as an integral part of national audit legislation comprise constitutional provisions on national audit, the Audit Law, and other legal statutes on national audit.

4.1.1 Audit legislation

4.1.1.1 The Constitution of the People’s Republic of China

The Constitution of the People’s Republic of China (“Constitution”) as the supreme law of the People’s Republic of China delineates the basic duties of auditing authorities and the legal status of national audit. Article 62 provides that the National People’s Congress shall, in accordance with the nomination of the Premier of the State Council, decide the candidates for the Auditor-General; Article 91 authorizes the State Council to set up an audit body to supervise, through auditing, the fiscal revenues and expenditures of the departments of the State Council and local governments at all levels, and the financial revenues and expenditures of the state’s fiscal and financial institutions, enterprises and organizations. Under the leadership of the Premier of the State Council, the auditing body shall exercise the legal power of audit supervision independently and shall not be interfered with by other administrative agencies, social organizations and individuals.

4.1.1.2 The Audit Law of the People’s Republic of China

The Audit Law of the People’s Republic of China (“Audit Law”) was promulgated on January 1, 1995 and amended in February 2006. The Audit Law as the basic law on auditing and the core of audit legislation stipulates the national audit system of China. The Audit Law provides a comprehensive set of regulations on national audit, i.e. the basic principles of audit supervision, auditing agencies and auditors, duties and functions of auditing agencies, powers of auditing agencies, auditing procedures and legal responsibilities etc. The Audit Law comprises the procedural and organic rules for auditing agencies as well as the substantive provisions. Under the Audit Law, auditing agencies supervise through auditing the budget implementation and final financial report of government-invested and substantially government-invested construction projects.

4.1.1.3 Relevant financial and economic laws

In addition to the Audit Law, relevant financial and economic laws, e.g. the Accounting Law, the Budget Law, the Government Procurement Law and the Law on the State-Owned Assets of Enterprises, form an integral part of China’s audit legislation. For example, under the Government Procurement Law, auditing agencies shall be responsible for audit supervision of government procurement. The government procurement regulators and the parties involved in government procurement activities shall be subject to audit supervision; under the Law on the State-Owned Assets of Enterprises, the auditing agencies of the State
Council and local governments shall audit the budget implementation of state-owned capital and state-funded enterprises subject to audit supervision.

4.1.2 Administrative regulations on national auditing

Administrative regulations on auditing, at national and local levels, are an integral part of China’s audit legislation. The administrative regulations on auditing currently in force include the Implementing Regulations of the Audit Law, the State Council Guidelines for Strengthening Audit, and the Framework Proposal for Addressing Key Issues in Audit System etc.

4.1.2.1 Implementing Regulations of the Audit Law

The Implementing Regulations of the Audit Law were promulgated by the State Council in October 1997 and amended in February 2010 to facilitate the implementation of the Audit Law. Government-invested and substantially government-invested construction projects defined in the Implementing Regulations of the Audit Law include i) construction projects entirely financed with public funds such as budgetary investment funds, special-purpose construction funds or government debt etc; ii) construction projects partly financed with government funds, with public funds accounting for over 50% of the total investment; or iii) construction projects partly financed with public funds, with project construction and operation in government control in spite of government funds accounting for less than 50% of the total investment.

4.1.2.2 State Council Guidelines for Strengthening Audit

In October 2014, the State Council announced the Guidelines for Strengthening Audit, providing the institutional support for audit excellence, in a bid to i) highlight the role of audit in facilitating the successful implementation of national initiatives and policies; ii) strengthen the role of audit in monitoring the various aspects of administration, anti-corruption and accountability; iii) oversee public funds, state-owned assets, state-owned resources and economic accountability of officials through comprehensive auditing; and iv) improve the existing audit supervision mechanisms. All departments, organizations and individuals involved in the management, allocation and use of public funds, state-owned assets and state-owned resources are subject to audit and expected to cooperate with the auditors without putting obstructions. These departments and organizations are required to provide the comprehensive information on financial accounting, business activities and management, electronic data and technical documents in a timely manner.

4.1.2.3 Framework Proposal for Addressing Key Issues in Audit System

In November 2015, General Office of the CPC Central Committee and General Office of the State Council issued the Framework Proposal for Addressing Key Issues in Audit System to ensure the independence of auditing agencies in audit supervision. The framework proposal envisages a sophisticated audit supervision mechanism regime to be developed by 2020 in line with the needs for the modernization of national governance structure and competence, and requires heightening the role of audit in ensuring the successful implementation of
national initiatives and policies, safeguarding national economic security, deepening reforms, promoting the rule of law and building a clean government.

4.1.3 Rules and procedures for national audit

National audit rules and procedures include ministerial and local rules and procedures for auditing. Equally authentic, these rules and procedures are enforceable within their respective scope of jurisdiction. The ministerial rules and procedures formulated by the National Audit Office are enforceable nationwide. The rules and procedures currently in force include the Implementing Rules for Economic Accountability Audit of CPC and Government Officials and SOE Executives, National Audit Standards of the People’s Republic of China, and the Procedures for Information and Assets Seizure in Audits etc.

4.2 PPP audit-related policy documents

4.2.1 Policy documents on government investment audits

With regard to the legislative aspects of PPP audits, local governments have been working on legislation to regulate PPP audits. For example, the Qingdao city in Shandong Province put the amended Qingdao City Audit Supervision Regulations into effect in November 2015 in a bid to step up audit supervision over PPP projects, protect the legal interests of non-government stakeholders (especially general public stakeholders), and improve the quality of PPP projects. Under these regulations, PPP projects will be audited. As authorized by the local government, auditing agencies will audit construction projects implemented under public private partnership arrangements that involve general public stakeholders.

Although it hasn’t been signed into law or ministerial regulations that PPP audits are mandatory, the role of auditing agencies and the scope of auditing set forth in some policy documents have dealt with the attributes of PPP projects, thus providing the basis for determining whether PPPs are subject to national audit.

The State Council Guidelines for Strengthening Audit expressly require audits to be conducted to oversee the implementation of policies and initiatives aimed at stabilizing growth, promoting reform, restructuring, improving living standards and mitigating risks and supervise public funds, state-owned assets, state-owned resources and economic accountability of officials, in a bid to enable comprehensive supervision through auditing, promote the modernization of national governance and bolster the healthy development of national economy.

The Framework Proposal for Addressing Key Issues in Audit System and supporting documents stress the need for auditing agencies to perform their duties in a lawful and thorough manner on the principles of i) government and CPC officials should be reviewed and treated equally; and ii) public funds, state-owned assets, state-owned resources and economic accountability of officials should be audited. Therefore, the scope of audit supervision is comprehensive and thorough, covering all departments and agencies involved in the management, allocation and use of public funds, state-owned assets and state-owned resources as well as CPC / government officials and SOE executives with an economic duty.
4.2.2 PPPs and mandatory audits

PPPs fall under the category of mandatory audits owing to their following attributes:

PPPs are encouraged by national policies and depends on whether such policies are put into operation effectively. Against the backdrop of the “new normal”, public private partnership is deemed a beachhead for the Chinese government to address financing bottlenecks and achieve industrial transformation and upgrade. PPPs are policy-oriented and characteristic of our times. Promoting PPPs is part of the ongoing efforts to implement the supply-side reform policies. Meanwhile, it’s a top priority for national audit to investigate the legal compliance of government-invested projects, ensure successful implementation of national initiatives and policies and make sure PPP-related activities take place within the legal framework.

PPP as an innovative mechanism for the delivery of public services aim at looking after public interests and improving living standards. An important goal of PPP projects is to improve the efficiency and quality of public services. Meanwhile, national audit is playing an important role in protecting public interests, streamlining project management and operation, and improving the quality of public services.

PPPs benefit from the improvements in the fiscal, investment and financing systems and requires a shift in government functions and a reform of the public finance management system. Under PPP arrangements, the private partner shares some of the public functions, which is subject to public finance management and performance evaluation, and the government assumes major responsibilities and risks through the entire life cycle of PPP projects. Meanwhile, it’s an important duty of national audit to prevent fiscal risks and promote the public finance management reform.

PPPs involve the use of public funds and prompt public performance and public finance safety concerns. PPP arrangements typically require public funding or resources (in the form of concessions etc.) and present remarkably public and legal attributes. Before a well-established institutional framework is in place, PPPs are likely to become the source of breaches and violations, such as bidding frauds, corruption and poor construction, at the cost of the safety and benefit of public finance. The scope of full-coverage auditing applies to the monitoring of the safety and performance of PPPs, when the safety and benefit of public resources, public funds and public assets are at stake.

4.3 Types of PPP audits

In terms of the objective of audit, a national audit can be a financial statement audit, compliance audit or performance audit. Financial statement audit, compliance audit and performance audit are just types of audits in theory. In practice, auditing agencies adopt an integrated approach to assessing whether the fiscal / financial balances of the entity being audited are true, legal and effective.

In terms of the type of activity being audited, a national audit can be a national policy implementation audit, fiscal audit, financial audit, enterprise audit, economic accountability audit, resources and environment audit, or foreign-related audit etc.
4.3.1 National policy implementation audit

A national policy implementation audit assesses how well local authorities and departments have performed in implementing the key policies and macroeconomic adjustment programs, including the concrete steps / progress, roadmap / progress, sources/allocation/management/use of fiscal funds, results achieved, and potential risks etc. A national policy implementation audit is wide-ranging on a macro level. The entities being audited include the State Council departments, local government and agencies as well as enterprises, organizations and construction projects involved in the implementation of such policies. A national policy implementation audit can be conducted in the form of follow-up auditing over a certain period of time, or as part of a combination of various auditing procedures.

4.3.2 Government investment audit

A government investment audit provides follow-up auditing of far-reaching, strategic and fundamental public infrastructure projects and oversees public goods and services delivered by government-invested or PPP-financed projects, highlighting decision-making, project approval, land acquisition and demolition, environmental protection, bidding / tendering, procurement, management and use of funds, and project quality management etc. A government investment audit is focused on project planning, investment structure and social/economic/environmental benefits etc., with an aim to promote the reforms in the investment and financing system, increase effective investment, optimize supply structure and improve investment performance.

4.4 Audit opinion report and audit work report

4.4.1 Audit opinion report

The Audit Law stipulates that CNAO shall submit to the Premier of the State Council an annual audit opinion report on the implementation of central budget implementation and other fiscal revenues and expenditures. The Audit Law allows auditing agencies to publish the audit findings and sets forth the regulations on public announcement of audit findings for this purpose.

4.4.2 Audit work report

Under the Audit Law, the State Council and the local governments at or above the county level shall submit to the standing committee of the people's congress at the same level an audit work report issued by the auditing agencies for budget implementation and other fiscal revenues and expenditures. In practice, the governments at all levels generally authorize the auditing agencies to prepare such reports. After being reviewed by departments concerned and approved by the administrative head of government at the same level, the head of the auditing agency will report on behalf of the government to the people's congress at the same level.

The audit work report is based on the audit opinion report, but there are still significant differences between the two. The audit opinion report is the report of the auditing agency to the people's government at the same level, focusing on the problems and
recommendations. The report provides a comprehensive and thorough overview of other fiscal revenues and expenditures, in addition to budget implementation. The audit work report is the report of the people's government to the people's congress at the same level and its standing committee, as part of being responsible to, reporting to and receiving scrutiny from the people's congress at the same level and its standing committee. Focused on problems and how they're tackled and rectified, the report elaborates on the audit work over budget implementation, enabling the people's congress and its standing committee to perform the duty of reviewing the audited government’s budget outcome and monitoring budget implementation.

The standing committee of the people’s congress usually follows an agenda that combines the hearing of the audit work report and the review of the audited government financial report. Before the audited government’s budget outcome report are reviewed and approved, the committee will listen to the budget outcome report issued by the financial department and the audit work report issued by the auditing agency for budget implementation and other fiscal revenues and expenditures, in order to have a comprehensive and objectively grasp the government's financial management and strengthen the supervision of budget implementation and other fiscal revenues and expenditures. The committee will urge the government to take actions to solve the problems in budget implementation, make sure budget implementation is taken seriously and ensure an effective role of the people's congress in budgetary supervision. The Audit Law also requires the State Council and the local governments at or above the county level to report to the standing committee of the people's congress at the same level about the rectification of problems identified in auditing to ensure the corrective measures are implemented effectively.

### 5. An overview of PPP audit research in China

As PPP is still in its infancy in China, improvements are yet to be made in the areas such as legislation, institutional capacity and best practices etc. CNAO is investigating the various types of PPP audit, methods and procedures as well as reporting requirements, amidst an evolving legal and policy environment. Local audit offices have conducted only a couple of project audits in an exploratory manner. This part intends to provide a theoretical analysis on PPP audit.

#### 5.1 Types of audit conducted by CNAO

National audit is the cornerstone and important guarantee for national governance. Meanwhile, PPP represents one of the key initiatives of the Chinese government to take reforms forward and achieve the goals for national governance. In view of what is coming with the “new normal” and what is inherent to PPPs, a life-cycle approach should be adopted for PPP audit from the perspective of national governance to audit and evaluate PPP projects at a multiple of dimensions, i.e. policy implementation, regulatory compliance and investment performance etc. In addition, given the role of the government in PPPs, PPP projects audit inevitably involves compliance audit, performance audit, national policy implementation audit and livelihood audit etc. As a result, a PPP audit combines a range of audit procedures characterized as preventative (objectives of audit), well-timed (the auditing time), ongoing (the auditing process) and extensive (the scope of audit).
5.1.1 Compliance audit

A compliance audit assesses whether a PPP project is in compliance with laws, regulations and rules it is required to comply mainly in the following three aspects. i) Whether the entities involved are eligible under the applicable laws, regulations and rules. ii) Whether the scope, terms of conditions and duration of partnership of the PPP arrangement are permitted under the applicable laws, regulations and rules. iii) Whether the activities involved, including identification of project, assessment of value for money and fiscal affordability, government procurement, construction, operation, maintenance and handover, are in compliance with applicable laws, regulations and rules.

5.1.2 Performance audit

A performance audit assesses a PPP project mainly in terms of investment performance of public funds, economic and social benefits of such project, with a focus on, among other things, the performance of fiscal incentives and subsidies. At the end of 2015, the central fiscal authority launched fiscal incentives in place of subsidies for PPPs under a financial inclusion program, in a bid to support and encourage standard-based PPP practices, ensure the quality of project implementation and highlight the guiding role of fiscal funds. With a project-specific sum up to RMB 8 million, incentive funds are used under the fiscal spending plan through the life cycle of a PPP project, mainly in the form of upfront subsidies and operational subsidies. As at the end of August 2016, 12 provinces and municipalities, including Beijing, Jiangsu and Yunnan, have announced local policies on PPP-related incentives and subsidies. Under these policies, a PPP project will receive a public grant up to RMB 20 million. In addition to making sure these funds are properly allocated and used and preventing violations such as fraud and embezzlement, the focus remains on how such financial incentives have helped deliver results, guide private investment into infrastructure and public services and promote standard PPP practices.

5.1.3 National policy implementation audit

A national policy implementation audit mainly assesses:

a. Implementation of major policies: The auditor will oversee the concrete steps taken by the local authorities and departments to implement the national policy guidance for PPPs, review the progress and results achieved, identify and report any negligence or violation, and make sure these policies are effectively implemented.

b. Provision of key funds: The auditor will oversee and review how public funds are managed and used in PPPs to identify and report issues such as withholding funds, inadequacy, inefficiency, loss and waste and make sure such fiscal funds are properly allocated and used.

c. Improvement of institutional framework: The auditor will oversee and review regulatory guidelines and local rules to make necessary changes to the existing laws, regulations and rules that give rise to regulatory constraints on the implementation of PPP policies.
d. Risk mitigation: The auditor will watch closely the vulnerabilities and potential risks in PPPs in relation to fiscal support, financing, people livelihood, state-owned assets, energy, resources and environmental protection etc., with a focus on the substantial increase in the government’s contingent liabilities as a result of the extensive participation of state-owned enterprises in PPPs. Emerging problems will be identified and reported. Meanwhile, early warning will be given, together with recommended steps to solve the problems and mitigate the risks.

5.1.4 Livelihood audit

Livelihood projects are subject to heightened efforts to oversee the use of funds for poverty alleviation, “Sannong” (agricultural subsidies), social security, science and technology, culture, education and disaster relief etc., in a bid to promote and deepen reforms, maintain and improve living standards and safeguard people’s interests. Livelihood audits focus on where the money goes, monitoring the process from policy guidance, budgeting, allocation of funds, to the projects and individuals with access to such funds, in a bid to make sure these policies on livelihood improvement are properly and effectively implemented and constantly perfected.

5.2 The difference between PPP audit and other types of audits

Auditing a PPP project is different in terms of the way of thinking. PPPs involve a diversified range of investment entities, sources of capital, financing arrangements and interests. The public attributes of PPPs are delegated and no longer delivered by the government alone. Meanwhile, at the core of PPPs is the need to “abide by the contract” in line with the rule of law. Audit agencies should adapt to the profound changes in the scope and forms of public investment and financing, instead of sticking to the conventional way of thinking that believes the scope of auditing is limited to fiscal funds and government investment with a focus on construction costs and management procedures. Therefore, a PPP audit should be conducted in accordance with the objectives and requirements of policy guidance to determine the relationship between the public and private entities involved and how their rights and responsibilities are exercised and performed; identify debt risks and government credit risks, public funding performance and project performance etc.; make available public policies, public resources, public services and public benefits; and safeguard the national economic security.

Auditing a PPP project is different in terms of a diversified set of policy objectives. PPP represents one of the key initiatives to achieve steady growth and promote reforms. A PPP audit should concentrate on whether the policy objectives have been successfully accomplished: i) enhancing the ability to provide public goods and services in an efficient manner; ii) introducing creative investment and financing mechanisms, broadening access to capital for urbanization projects and strengthening the endogenous dynamics of economic growth; iii) facilitating the shift in government functions and refocusing on decision-making, regulatory and administrative services. PPP audit will help develop an institutional framework and create a positive environment for the healthy development of PPPs while investigating malpractices and irregularities, such as setting up fake PPPs to obtain public funds, state-owned assets and state-owned resources against the laws and regulations.
Auditing a PPP project is different in terms of the emphasis on the concept of contract. A PPP audit is designed to protect the legitimate interests of the public and private entities involved by assessing how well the PPP contract is abided by. Under PPP arrangements, the public and private partners are equal in legal status with their rights and obligations established in the contract. This contract is formulated on the principle of full consultation and mutual benefit to provide a legal and valid basis for the implementation and life-cycle management of PPP projects. The need to “abide by the contract” poses a new challenge to the government’s respect for contractual relationship and collaboration. A PPP audit focuses on whether the rights and obligations of the parties involved are clearly defined and performed as agreed. Major changes taking place in the process of implementing a contract, such as changes to the term of contract (extension or early termination), changes in its provisions (adjustments in project deliverables or prices) and changes in ownership (transfer or assignment), will be closely watched to prevent the lack of binding constraints. Breach of contract and credit risks on the government side are also major concerns. Such risks are mainly the result of i) the failure of some local governments to deliver on their commitment to preferential treatment or financial support in the implementation stage of PPPs; or ii) the failure of some local governments to provide necessary services, which gives the private entity an excuse for breach of contract and leads to project suspension or delays.

Auditing a PPP project is different in terms of the stage-based continuum. A PPP audit will track the entire life cycle of a PPP project based on an in-depth understanding of what’s going on in each life-cycle stage. PPPs have a trajectory of dynamic development, from setting up a project company, funding the project, operation and maintenance, to transfer. The activities and risks involved in each stage vary. A PPP audit should be designed to cope with the typical situations and bolster the unique advantages in each life cycle stage, with an aim to make improvement through the life cycle, keep the project on the straight and narrow, and achieve the policy objectives and promised returns.

5.3 Goals of PPP audit

5.3.1 Overall goals

Ensuring effective communication of public policies: PPP audit activities will oversee the concrete steps taken by the local authorities and departments in implementing the national policy guidance for PPPs, review the progress and results achieved to identify problems, and analyze root causes in a timely manner.

Facilitating rectification and accountability: PPP audit activities will uncover major problems in the entity being audited, such as inaction, delay in action and false action; identify material malpractice and misconduct, loss and waste, risks and dangers, and irregularities and violations etc.; and suggest corrective measures to be taken.

Promoting institutional innovation: PPP audit activities will result in creating new methods and rules in line with the PPP policies and requirements, based on the findings of such audits; laws, regulations and rules that are outdated, restrictive or obstructive will be removed or amended accordingly.

Bolstering structural reform in the supply-side: PPP audit activities will contribute to the
ongoing efforts in streamlining exploratory practices, identifying innovative approaches and introducing new institutional mechanisms; put forward constructive ideas to address mismatched, unaligned and even contradictory measures in the PPP reform and make sure the reform is carried out in a coordinated way; bolster the provision of national infrastructure and public services, and bring the joint endeavors in delivering infrastructure projects and public services to the next level.

5.3.2 Specific goals

The public sector involvement in PPPs varies. However, there are similarities across different types of PPPs in terms of underlying policies, implementation processes and duties of fiscal authorities. The audit agency needs to meet the following goals in a PPP audit.

Making sure PPP policies are effectively implemented: The aim is to find out whether the PPP arrangement has been properly and effectively implemented; whether the public sector authorities have played the role of administrative supervision in the process of project implementation, specially over practices and activities in relation to the quality of public goods and services, user charges and payment mechanisms, production safety, environmental protection and labor rights etc., according to national laws and regulations.

Making sure PPP arrangements are properly used: The aim is to find out whether a certain PPP arrangement has been selected in accordance with the policy guidance; whether the rights and obligations stated in the contract are in line with this PPP arrangement; and whether there is any violation or irregularity during the implementation process.

Making sure the objectives of PPP projects are met by conducting performance reviews: The aim is to assess the role of industry regulators in offering regulatory oversight over the quality / price of public goods or services delivered under the PPP contract; set up an integrated evaluation system involving public sector authorities and users; and provide performance reviews on performance indicators, management of operations, use of funds, quality of public services and customer satisfaction.

Promoting a shift in the functions of government: The aim is to facilitate a shift from “subsidies for construction” to “subsidies for operation” in the management of financial support from fiscal authorities. Fiscal spending categories such as public subsidies are included in the local government budgets as part of medium-to-long-term fiscal planning. Fiscal authorities at all levels are urged to develop a holistic approach to debt management and risk mitigation. The audit agency will monitor the statistical information on public grants and subsidies, keep the government’s contingent liabilities under control, and manage risks associated with the transformation of PPP projects originally funded by government-owned financing platforms.

Promoting the reform in China’s fiscal and taxation system: The aim is to create and perfect a multi-year budgeting mechanism, develop the medium-term fiscal plan and prepare the consolidated financial statements that fully reflect the state of the government’s balance sheets.
5.4 Methods and techniques of audit

5.4.1 Methods of audit

Audit procedures have become more sophisticated over time. Currently, audit agencies are using a range of methods and procedures including special investigations, follow-up audits and large-scale centralized audit programs etc.

5.4.1.1 Special investigations

The functions and duties of audit agencies are defined in the Implementing Regulations for the Audit Law of the People’s Republic of China, specifying that “audit agencies may, under the Audit Law, these implementing regulations and other applicable rules and regulations, initiate special investigations over issues concerning public finance, such as budget management and use of state-owned assets, in a certain region, department or entity”. A special investigation is different from an audit. It is targeted mainly at specific issues of a broad, universal, demonstrative nature emerging in the process of socio-economic development and reform, in a bid to understand, analyze and interpret what’s going on, identify the root cause and offer advice to support decision-making of the government and relevant departments. Therefore, special investigations are helpful to bolster the constructive role of audit oversight.

5.4.1.2 Follow-up audits

Follow-up audit is a type of audit procedure originally used to audit government investment before its adoption in other areas. A follow-up audit is initiated by the audit agency under the applicable laws and regulations to oversee the activities of the entity being audited and such dynamic oversight will continue as an ongoing process. The National Audit Office’s 12th Five-year Audit Development Plan makes it clear that process-based follow-up audits are required for major construction projects, resources development and environmental protection matters, public emergencies and the implementation process of key policies that are of national importance.

A follow-up audit follows and monitors the entire process and life cycle of the project being audited. The entire process comprises several stages from project formulation, construction and operation to evaluation. In the project formulation stage, the scope of auditing covers the legal compliance of decision making, rationality of investment budget, legal compliance of bidding and integrity of contract etc. In the construction stage, the audit deals with cost control, project quality and project progress etc. In the evaluation stage, the audit examines whether the construction and operation costs are justified, whether the requirements on construction and ability to deliver public services are met, and whether the quality of public services is satisfactory etc.

5.4.1.3 Large-scale centralized audit programs

A large-scale centralized audit program is initiated and organized by a higher-level auditing authority across the country, a province or a large geographical coverage. The audit program is characteristic of centralized management in terms of audit planning, leadership, standards, reporting and press release. The organizer should see to it that the audit program is well
organized and the participating agencies should enhance communication and work closely with each other to ensure the quality of auditing.

5.4.1.4 Big data-driven audits

The big data approach enables an in-depth, sophisticated and comprehensive analysis of data, and supports an audit procedure involving overall analysis, identification of problems, targeted investigation and systematic research. A big data-driven audit is based on a cross-disciplinary, cross-sectoral and multi-tier correlation analysis in five interrelated and interactive aspects, i.e. correlation analysis of data in fiscal, financial and business entities; correlation analysis of data at the central government, authority and local government levels; correlation analysis of data on financial and business activities; correlation analysis of data collected at different levels within an authority; and correlation analysis of data collected from the entity being audited, industry / sector, region and the macroeconomic system.

These auditing procedures have their own usages and advantages. A PPP project audit can be a combination of various types of audit procedures.

5.4.2 Audit techniques

Inspection, observation, inquiry, investigation, recalculation, reperformance, and analysis are some of the techniques commonly used in the audit process.

Inspection: The auditors will review the records or documents indicating large amounts, whether in hard copy, electronic forms or other forms of media, and whether generated inside or outside the entity being audited;

Observation: The auditors will examine the premises, physical assets, business activities and the implementation of internal controls of the entity being audited through on-site inspections to collect information about business environment, operations and effectiveness of internal controls.

Inquiry: The auditors will ask questions, based on the problems and doubts identified in the audit process, to confirm facts or written information and collect audit evidence. Inquiry helps reveal the underlying logic for key issues, determine what has gone wrong and identify the department/people responsible for noncompliance.

Recalculation: The auditors will use information technology to verify the accuracy of data.

Reperformance: The auditors will independently repeat the business procedures or control activities.

Analysis: The auditors will examine the correlation between financial data or between financial and nonfinancial data and evaluate the relevant information, with a focus on abnormal volatility and discrepancy.
6. Challenges or barriers facing PPP audit

There are challenges and difficulties inherent to PPP audits, which stand in the way of ensuring the quality and meeting the goals of such audits. Given the policy environment, industry involvement, key stakeholders and investment/financing needs and taking into account the contributing factors to the success of a PPP audit, we believe the main challenges and difficulties associated with PPP audit in China are as follows:

6.1 A paradigm shift is needed

Section 5 looks into the difference between PPP audit and other types of audits. A systematic, in-depth understanding of the traits of PPP audit and the resulting paradigm shift are vital to the success of these audits. PPP audit is yet to be widely adopted in China and PPP projects are still treated as public projects where the interests of the government prevail over those of the private sector partners, indicating nonconformity with the criteria of PPP audit. Auditors have yet to adopt a comprehensive, up-to-date and systematic approach to auditing, which could take a long time. There is a need to look into systematically and thoroughly the situations, issues and changes coming with the widespread use of PPP arrangements to enable a paradigm shift quickly.

6.2 PPP-related legislative issues are yet to be addressed.

The main legislative barriers to PPP audit are as follow:

a. Some rules contained in the current Audit Law are inadequate to deal with the new environment for investment audit. The Audit Law was originally enacted in 1994 and revised in 2006. It has played an important role in advancing and supporting the best practices of auditing. However, given the political and economic environment, knowledge and practices at that time, the law has its own flaws and limitations, e.g. failure to foresee the changes coming with the reforms in the investment and financing system, especially the widespread use of PPP arrangements. All this leads to legislative gaps and lack of regulation in auditing PPP projects.

b. The existing regulations on PPP audit show problems such as inconsistency and lack of binding effect. In March 2015, the General Office of State Council demanded heightened efforts to audit and monitor government-invested projects, SOE-invested project and other Public-Private Partnership public projects in the Guidance for Introducing Innovative Investment Management Practices and Creating a Collaborative Regulatory Mechanism. In May 2015, the Regulations on Concessions for Infrastructure and Public Utilities issued by NDRC and other five ministerial departments stated that PPP projects in the form of concession should be audited by local audit agencies (county-level or higher). These requirements on auditing PPP projects (concessions etc.) are, at some point, inconsistent and unaligned with the Audit Law, making it difficult to implement or even giving rise to legal disputes.

c. The accounting and reporting systems for PPPs have yet to be improved. The formulation of accounting standards governing project accounting and reporting of PPPs is still under way. Consequently, the quality of information and the level of information
disclosure are inadequate, due to the lack of guidance for accounting and reporting procedures to be adopted by the public sector and private sector partners in preparing their own financial statements. All this results in the absence of information required for auditing PPP projects.

d. Although a swarm of PPP-related policies have been announced, the research on PPP auditing is largely theoretical. CNAO and local audit agencies have yet to look into PPP auditing systematically and thoroughly and provide the guidelines for PPP audit.

6.3 Auditors need to build up skills and competencies.

PPP projects typically involve a broad range of areas, a large size of investment, a long period of construction and a multiple of stakeholders etc., which requires higher levels of knowledge and skills for auditors. Representing a new approach to project audit, PPP auditing relies on the insight into policy guidance, a wide set of skills and innovative approaches. Currently, China is starved of qualified talent, i.e. people who are equipped with expertise and skills in finance, fiscal management and engineering. Meanwhile, we should keep our knowledge up-to-date about project appraisal, budgeting and legal matters and build up capabilities for comprehensive evaluation, big data analysis and strategic analysis. Therefore, audit agencies should examine the roles, duties and functions of auditors and set forth the knowledge and skills requirements for PPP audit.

6.4 The institutional setting of audit resources is outdated.

The existing institutional apparatus in Chinese audit agencies emphasizes the functions of each department. Despite an important role in taking auditing practices forward, this institutional arrangement is an obstacle to the comprehensive monitoring of socioeconomic activities and the consolidation/optimization of audit resources. PPP auditing is uniquely in need of cross-disciplinary knowledge, multi-faceted analysis and a holistic approach. It is a combination of various types of audit processes designed for PPP projects with a long-term timeline. Therefore, audit agencies should make a shift towards a project-based, cross-disciplinary team to enable collaboration across the organization and the effective consolidation of human resources. In addition, as PPP projects are evolving in an open, dynamic environment, the contributing factors to the quality of auditing are complex, which means, audit agencies need to be adaptive in this process while stepping up standard-based quality management efforts to ensure effective process control.

6.5 There is a need to gain experience on PPP audit.

In China, the research on the scope, methods, techniques and organizational structure of PPP audit has yet to be stepped up. Due to the lack of systematic, proven experience, audit agencies need to strengthen their efforts in planning management, quality management and cost management of audit projects; pick up the pace of building databases and creating a big data platform to enable a correlation analysis of cross-disciplinary, multi-tier and inter-system PPP data; and provide training for auditors to build the competencies required for conducting performance reviews, evaluating macroeconomic implications and predicting potential risks etc.
6.6 **Guidance for independent audit and internal audit in PPP projects is inadequate.**

Representing a brand-new type of project audit, PPP auditing involves both the public and private entities and covers quality control activities at different levels through the life cycle of PPP projects. Therefore, audit authorities, certified public accountants and internal audit departments will take different perspectives on how to audit a PPP project. Due to reasons such as being understaffed or lacking the required expertise, the audit authority will sometimes purchase auditing services from independent auditors or refer to the results of internal audits. As a result, the quality of a government audit is affected vitally by the quality of internal or independent audits, which requires the audit authority to step up their quality management efforts. On the one hand, it should provide guidance for internal audits; on the other hand, the audit authority should examine the audit reports issued by independent auditors.
1. Executive Summary

Public private partnerships (PPPs) are being increasingly employed by governments for creating and providing infrastructure services. PPPs are popular because they allow off-balance sheet financing to governments while harnessing private sector efficiencies. PPP arrangements are however delivery models and do not alter the accountability relationships. The accountability of the public promoter/partner for the public service and the need for assurance from the public auditor remains unaltered. The complexity of the PPP arrangement involving sharing of risks and responsibilities is a challenge that public auditors today increasingly face.

India has implemented a number of infrastructure projects in the PPP mode over the past two decades. SAI-India has taken up audit of these PPP arrangements initiated by both Union and State governments. These audits have focused on the PPP delivery model, its plan and execution, value derived by the public promoter/partner from the arrangement as well as the effect on the users. The findings and recommendations of PPP audits have been well received by the public promoter/partner.

PPPs arrangements transfer risks to the private partner which leads to loss of control and lack of audit trail with the public promoter and poses a challenge for public audit. The public auditor remains focused on the public promoter/partner (auditee), though the auditor may require access to records of private partners to satisfy the audit objectives in some cases. The mandate of SAI-India, as clarified judicially, encompasses access to records of private entities, if necessary. In practice, access to private records have not been denied though the process of such access has not been smooth.

With PPP emerging as a dominant mode in public infrastructure, audits of PPP arrangements have gained importance. The complexity of PPP arrangements poses challenges of knowledge and experience to the public auditor which needs to be overcome with continuing education and training of the staff.

2. Existing Legal and Statutory Framework in India for governing and regulating the PPP arrangements

2.1 Defining a PPP arrangement

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’. Ministry of Finance, Government of India, defines PPPs as

‘A PPP means an arrangement between Government or statutory entity or Government owned entity on one side and a private sector entity on the other, for the provision of public assets and/or related services for public benefit, through investments being made by and /

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or management undertaken by the private sector entity for a specified period of time, where there is substantial risk sharing with the private sector and the private sector receives performance linked payments that conform (or are benchmarked) to specified, pre-determined and measurable performance targets’.

PPP, thus, is an arrangement for creation and/ or management of public assets and infrastructure services, which have been traditionally government monopolies, through a private partner. The public partner initiates, monitors and regulates the project while the private partner invests, constructs and manages it. The arrangement helps overcome capital budget constraints of governments while harnessing private sector efficiencies. PPP arrangements are usually long term and involve transfer of risks. In fact, the success of a PPP arrangement often depends on appropriate allocation of risks between the public and private partner. A corollary to private partnership in delivery of monopolistic services has been the growth of independent regulatory agencies to ensure transparency and fair play in their actual implementation.

2.2 Key features of PPP arrangements

The essential conditions of PPPs, as defined by the Government of India, include:

• **Arrangement with private sector entity** which is usually a contractual one that enables the private sector to provide a public asset/ deliver public service and sets out a mechanism for sharing risks and rewards.

• **Provision of public asset or service for public benefit** as PPP transfers only those facilities / services to the private partner which have so far been provided by Government as a sovereign function.

• **Investments being made by and/or management undertaken by the private partner** as PPP projects could also be where the private partner does not make financial investments but is partnered with to harness its efficiency for better service delivery.

• **Time period** for the PPP arrangement is specified as per contractual conditions. No PPP arrangement goes on perpetually.

• **Risk sharing** is a prime feature as both public and private partners are allocated risks which they are best suited to manage and mitigate.

• **Performance linked payments** as PPP arrangements usually provide for quality of service delivery and performance, not merely provision of an asset/ facility.

• **Conformance with performance standards** which are pre-determined and measurable, specified by the public partner.

2.3 PPP framework in India

Usually, PPP arrangements are seen in infrastructure sectors. The Ministry of Finance, Government of India has notified (October 2013) a harmonised master list of infrastructure sub-sectors which include
• **transport** (roads and bridges, ports, inland waterways, airports, railways, urban public transport),

• **energy** (electricity generation, transmission, distribution, oil and gas pipelines and storage facilities)

• **water and sanitation** (solid waste management, water supply and treatment, sewage collection, treatment and disposal, irrigation, storm water drains, slurry pipelines)

• **communication** (telecommunication fixed networks, towers, telecom services)

• **social and commercial infrastructure** (capital stock of educational institutions and hospitals, common infrastructure for industrial parks/special economic zones, post-harvest storage infrastructure, fertiliser, cold chain, etc.).

These are the key infrastructure sectors which have seen a number of PPP projects in India over the last two decades.

All PPP arrangements have to conform to the legal and regulatory framework. As per the Constitution of India (1950), legislative rights pertaining to specific sectors are divided among the Union and the State governments. Some infrastructure sectors which are in the legislative remit of the Union government include ports, airports, railways, national highways, inland waterways, telecom, oil fields, mineral resources. Specific Union laws govern these areas; for example the *National Highways Authority of India Act* provides the legislative framework for construction, management and operation of national highways across the country. Infrastructure sectors in the State list include public health and sanitation, State highways, water supply, irrigation, etc. Each State has its unique, specific law governing them. Any PPP project, thus, has to be within the framework of the law (Union law or State laws) governing the sector.

The public partner (Union or State government department or agency) who enters into the PPP arrangement should be enabled by the relevant legal framework to take up the project and should have the legal authority to transfer rights (concession) to a private partner for implementation of the project. At the Union level, there is no overarching legislation enabling or setting out the PPP framework. Union laws in individual sectors, however, have been amended or enacted to facilitate private participation. A case in point is the National Highways Act, 1956 which was amended in June 1995 to allow private sector to levy, collect and retain fees from road users which facilitated PPP in construction, management and operation of national highways in the country. Another example is the enactment of the Electricity Act, 2003 which allows entry of private licensees in transmission and distribution. Some State governments, have however, enacted laws to facilitate private sector participation in infrastructure projects. For example, the Bihar Infrastructure Development Enabling Act, 2006 facilitates private sector participation in the designing, financing, construction, operation and maintenance of infrastructure projects in the State.

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7 India is a union of States. Presently there are 29 States in India. Each State has an elected government, the governance model of the State governments closely mirroring that of the Union government.
Thus, PPP arrangements in India, have been enabled and are being governed by laws (Union or State laws which could be sector-specific) which have been enacted or amended. To enable private participation, the legal framework usually provides for levy and collection of user fees from beneficiaries and empowers the private partner to collect such fees which serves as the consideration of the private partner for implementing the PPP project. The legal and policy framework also provides for transparency, monitoring and evaluation of the PPP project to ensure that the project objectives are realised. The policy framework also sets out the processes for designing, appraising, approving a PPP project and its contracting (model documents including RFQ, RFP, concession agreement in specific sectors have been designed). In some sectors independent regulatory bodies have been established by statute to govern the activities in the sector and ensure continued transparency and fair play. A case in point is the establishment of a statutory body, the Airports Economic Regulatory Authority (AERA) under the AERA of India Act, 2008 at the time private partnership in development, management and operation of airports in India were being institutionalised. AERA regulates service at airports, determines the tariff for aeronautical services and monitors the performance standards (quality, continuity, reliability of service) of airports.

3. Types of PPP arrangements in India

3.1 Types of PPP arrangements

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<tr>
<th>Option</th>
<th>Ownership</th>
<th>Financing</th>
<th>Management</th>
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<tr>
<td>10. Privatisation</td>
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<tr>
<td>9. Build, Own, Operate (BOO)</td>
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<td>Private</td>
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<tr>
<td>8. Build, Own, Operate, Transfer (BOOT)</td>
<td>Private then public</td>
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<tr>
<td>7. Design, Build, Finance, Operate (DBFO)</td>
<td>Public</td>
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<td>6. Design, Build, Operate, Maintain (DBOM)</td>
<td>Public</td>
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<td>5. Build, Operate, Transfer (BOT)</td>
<td>Public</td>
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<td>4. Lease, Operate (LO)</td>
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<td>3. Management Contracts</td>
<td>Mgmt Contract</td>
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<td>2. Service Contracts</td>
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<td>1. Government directly providing public service</td>
<td>Public provided</td>
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International Federation of Accountants (IFAC) has identified different models of PPP based on different degrees of private involvement in concession agreements. One extreme is the traditional model of public service delivery where the Government/public agency directly provides the public service and manages all risks associated with the project while the other extreme is privatisation of the these services where the private agency is transferred all risks related to the project.

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8 RFQ: Request for Qualification
9 RFP: Request for Proposal
10 Accounting and Financial reporting for service concession
PPP models between these two extremes have different degrees of risks and responsibilities sharing among the private and public partner.

3.2 Basic PPP models in India

The basic PPP models that are prevalent in India are management contracts, lease contracts and different variants of Build Operate Transfer (BOT) models.

- **Management contracts** are drawn up when a public entity engages a private partner to manage a range of activities for a short duration in return for a contribution. These are usually short term contracts focussing on a specific task. Most risks here are retained with the public partner.

- **Lease contracts** are drawn up when the underlying public asset is leased by the public entity to the private partner. These contracts are usually medium term contracts and may involve capital investment by the private partner. The private partner here often shares finance risk associated with the project. Variants include Build, Lease, Transfer (BLT), Build, Operate, Lease, Transfer (BOLT) etc.

- **BOT models** are typically employed for green-field projects where the development of the project, often including its financing, is assigned to the private partner. The private partner may maintain and operate the project after its development for a specified period. BOT agreements are typically long term agreements and a significant quantum of risk is transferred to the private partner including the finance risk, construction risk and revenue risk. Variants include Design, Build, Operate (DBO); Design, Build, Finance, Operate, Transfer (DBFOT); Build, Own, Operate, Transfer (BOOT) etc.

3.2 PPP models in different sectors in India

PPP models have been extensively employed in infrastructure sectors in the country. These PPP infrastructure projects cover the following sectors at present:

- **Transport** commands the maximum number of PPP projects. The largest number of PPP projects have been in the road sector mostly under the National Highway Development Programme. A significant number of port development projects have also been taken up on PPP. Development of green-field and brownfield airports on the PPP mode have also been initiated. Though the number of airport projects are not large, investment on these projects are very significant, besides long concession period that has been agreed to in these projects. A significant number of urban public transport projects including metro rail projects, bus stations and commercial complexes in and around bus stations have also commenced. In addition, few projects for railway track, tunnel, viaduct, bridges have been taken up on the PPP mode.
• **Energy** sector has taken up projects on PPP mode. These are largely electricity generation (grid) and transmission projects. A beginning is also being made in renewable energy generation (wind farm) and developing LNG storage facilities on PPP mode.

• **Water sanitation** is another area where a significant number of PPPs exist. These include sewage collection, treatment and disposal system, solid waste management systems, water supply pipelines and water treatment plants.

• **Social and commercial infrastructure** also has some PPPs. This includes common infrastructure for industrial parks and SEZs, cold chain, tourism, education and healthcare.

While a number of PPP models have been employed in infrastructure projects, the overwhelming majority of projects are in the BOT (Build-Operate-Transfer) mode. The BOT model has two variants, -

(a) user fee based BOT models which are awarded in sectors where it is feasible to levy an user fee and where the concessionaire recovers his investment and return through charges levied on the user and

(b) annuity based BOT models which are usually awarded in sectors where user fees are not feasible due to socio-political considerations or not enough to cover costs and the Government makes annual / semi-annual payments to the concessionaire for development, maintenance and operation of the infrastructure.

In some cases where it is felt that the private concessionaire would be better placed to take the design risk and that significant efficiency and quality advantages would result from such transfer of design risk, variants in the nature of DBFO (Design-Build-Finance-Operate) and DBFOT (Design-Build-Finance-Operate-Transfer) are employed. In cases where ownership is flexible and the private concessionaire can own the assets underlying the PPP, variants like BOO (Build-Own-Operate), BOOT (Build-Own-Operate-Transfer), BOOST (Build-Own-Operate-Share-Transfer) can be used as is seen in some cases in the energy sector. Assets like roads and highways would always remain with the public; ownership by private concessionaire is not possible and resultantly the majority of projects in the transport sector are BOT or DBFOT variants. In cases where transfer of ownership is not possible, lease is also an option with variants like LDOT (Lease-Develop-Operate-Transfer) as has been used in case of the airports. While the models discussed above are usually long term, shorter term PPP arrangements for management and operation of assets is also used. The PPP model used for a particular project depends on its financial viability, ownership flexibility and potential for innovation and efficiency.

### 3.3 Other arrangements with private partnership

In addition to the PPPs in infrastructure, Government has entered into partnerships with the private sector for exploitation of valuable, monopolistic natural resources. An example is the
award of hydrocarbon bearing blocks for exploration, development and production of oil and gas. While some of the blocks have been won by PSEs in competitive bidding, considerable private partnership and investment has been seen in the sector. Other instances are award of spectrum to telecom service providers and award of coal mines through competitive bidding mechanism.

4. Risks in PPP arrangements

4.1 Risk factors in PPP arrangements

Each stage of development of a PPP project, - its conception, execution, management and operation have significant risks. A balanced sharing of these risks between the public and private sector partners is essential for its enduring success. The INTOSAI ‘Guideline on best practice for the audit of risk in public/ private partnership’ discusses some of the key risks and means to mitigate the risk. Some of the major risks associated with PPP projects and concerns of the public auditor in face of these risks are summarised below:

4.1.1 Feasibility / Organizational Risk

This relates to the selecting the PPP arrangement appropriate for the project. The public partner (the Government or its agency) should consider possible alternatives for implementing the project, evaluate them and select the arrangement that is most appropriate and would yield best value for money. Public auditors may review the feasibility study carried out by the public promoter including demand projections, cash flow, rate of return etc., and assess whether the appropriate partnership model has been selected for implementing the project. The feasibility risk remains with the public partner (Government or the public agency responsible for the project).

4.1.2 Condition Precedent Risks

For implementing infrastructure projects, a set of conditions would usually need to be satisfied. For example, broadening of a highway project would involve acquisition of land for the expansion, environmental clearances, shifting utilities (electricity lines etc.) before the project can be implemented. These are usually designated as ‘conditions precedent’. Many of these risks are ideally addressed by the public partner. The private partner may accept these risks but in case of delays, the construction and operation of the project would be delayed, which in turn, may affect the timeliness of providing the service to be provided and also its revenue generation. The timely management of ‘conditions precedent’ risks are reviewed by audit.

4.1.3 Financing Risk

A major risk for any partnership project will indeed be the financing risk. Financing risk includes the ease with which the required finance can be raised for the project, as well as the cost of such finance. The requirement of finance will be dictated by the total capital cost and the return on investment that the investors would expect to earn. Usually, in PPP arrangements, the private partner brings in the finances for implementing the project and hence this risk is transferred to the private partner, which is responsible for raising the funds for implementing the project and for its repayment. However, the capital cost and the financing pattern will determine the grant of the concession; - the user charges and the period of the concession. Financing may also involve government guarantees and commitments (often implicit) in the event of contingencies. In other words, the risk related
to financing, though borne by the private sector partner, will impact the public promoter as well as the users significantly. An aspect to be kept in view is the collateral agreements between various partners within a consortium of bidders (the private partner) as well as the agreements between such consortia and the financiers if they are independent of the consortia. This is necessary because in more complex PPP arrangements the risks are widely shared with risk taken by one element of the arrangement being counter-balanced by the risk taken by another element of the arrangement on a back to back basis. Hence there is need for a very careful evaluation of all associated implications of the financing risks by the public auditors.

4.1.4 Construction Risk

In a PPP arrangement for infrastructure projects, construction risk is usually assumed by the private partner which would also have to bear the consequences of the delays and variations caused due its inefficiency. On the other hand, all efficiency gains achieved through design efficiency and innovations will be the reward for the private partner. This is as per the terms of the concession agreement. An objective of public auditors would therefore be to review the end result of a PPP project, not necessarily on how it was achieved. Appreciation of the risk allocations will enable focus of the public auditor.

4.1.5 Operation and Maintenance Risk

The public sector partner has to ensure the quality of maintenance and the standard of the service to the public. This will primarily depend on the specifications and conditions laid down in the Operation, Maintenance and Development (OMD) Agreements. The reports to be submitted by the Independent Engineers will provide detailed information on the quality and standards being followed by the private partners. However, the private sector partner will bear the consequences of under-performance in terms of scale and specifications of operation and maintenance of a public facility created under the PPP arrangement. It is possible that the private partner may diversify such risk by sub-contracting operation and maintenance to another party. In such cases, the agreements between the private sector partner and the operation and maintenance contractor is expected to be within the scope of audit.

4.1.6 Demand Risk

Demand risk is usually shared by both parties in the PPP arrangement. The demand projections are expected to be studied at the time the public promoter draws up the contours of the project. The private partner is also expected to conduct due diligence of the project parameters before bidding for it. However, PPP arrangements remain valid over long periods and over such long timeframes, the demand for services may change leading to significant variations between the projections and actuals. The PPP arrangements may provide for readjustments of the concessions /period of concessions to address such eventualities. Alternatively, there will be variations to the revenue sharing formulae depending on such variations. The public auditors may need to carefully review the demand risks and the allocation of such risks to ensure that they are balanced and reasonable from the public interest point of view.

4.1.7 Revenue Risks
Shortfall in demand and consequentially revenue, has the potential of destabilizing the PPP arrangement because the private sector partner may opt out in such circumstances. This may not only result in disruption of services but also delay ancillary development, thus adversely impacting generation of expected revenue. Shortfall in revenue generation will hurt both parties. While the public authority loses the prospect of providing better and early service to the public, the private sector partner will stand to lose potential income. Such variations can also entail higher amounts of annuity being paid to the private sector partner where the public authority is committed to do so under the PPP arrangement. Shortfall in demand and revenue can also result from unrealistically high level of user charges fixed under the PPP arrangement. It has, therefore, to be seen whether the tariff / user charges have been fixed in a way that addresses the best interest of the user community as well as the investors.

4.1.8 Risk from unforeseen developments

Unforeseen developments such as natural disasters are covered under contractual clauses relating to force majeure. However, there could be other developments which may relate to political and business environment, technological changes or any other factor that proves to be a game changer invalidating the assumptions on which the business model of a PPP arrangement rests. Such risks have to be envisaged under PPP arrangements and suitable provisions built in to allow all the parties particularly the public authority to extricate itself from such situations with minimal damage and to facilitate a movement forward out of a potential stalemate. The agreement between various parties may provide ‘step in’ and/or ‘buy out’ mechanisms to facilitate exit of one party and its substitution by another party to facilitate continuity of the project.

4.1.9 Termination Risk

This risk will arise if the private sector partner fails in the project because of its management failure, bankruptcy, dismal performance, indebtedness etc. The risk is borne by the promoting public sector partner. The auditor, in such cases, may need to examine whether the public agency has considered the possibility of such events and worked out a suitable strategy to address them. The Request for Proposal (RFP) issued by the promoter may be scrutinized to check whether all conceivable eventualities were taken into consideration to anticipate the termination risks and to cope with such situations, in case they arose.

4.1.10 Residual Value Risk

This risk arises at the end of the PPP contract when the asset is to be transferred back to the government or its agency, who will be holding the risk. The contract between the parties should include suitable provisions regarding the health of the assets, its valuation method etc. to avoid disputes and losses arising from poor maintenance of the assets and the assurance for their return in the desired conditions.

4.2 Mitigation of risks by public partner

For success of any PPP arrangement, the risks have to be optimally distributed between the public authority and the private concessionaire/ licensee. A public private partnership arrangement does not diminish the responsibility of the Government/ public agency to provide public services. As such, the primary responsibility for managing the risks of a PPP arrangement rests with the public partner. Appropriate due diligence on part of the public
partner is necessary at all stages of project planning, construction, operation and reversion to ensure that public interests are not compromised.

While structuring PPP projects in India, their viability is assessed by the Government/public promoter. A PPP project may be financially attractive for the private partner (an example would be a highway stretch with a very high anticipated traffic and hence high recovery of user charges) in which case the private partner may offer a premium or agree to share higher revenues with the public authority for the concession. However, there would also be infrastructure projects which are expected to benefit from private sector efficiencies when implemented in the PPP mode but are not financially viable (lesser number of users or low user fee). In such cases, Government of India offers VGF (Viability Gap Funding) to the private concessionaire upto 40 percent of the project cost which would render the project viable. In case of particularly un-viable projects, where the project viability does not improve even with VGF, an annuity model is considered where the Government takes on the revenue risk of the project insulating the private partner who is paid an annuity covering investment on the project and a reasonable return. Arrangements with private partner for exploitation of scarce natural resources like hydrocarbons, coal and spectrum, however, are uniformly revenue sharing ones. The model of revenue sharing, however, may vary – profit based sharing, revenue based sharing, payment of royalty & cess, etc. based on the sector and its complexities.

4.3 Concerns of the public auditor

During audit of a PPP arrangement, the question uppermost in the mind of the public auditor would be to ascertain how the risks associated with the PPP project impacts the public sector participants and the consumers at large in the medium and long run. Whether the risk allocations have been judicious and fair for the sustained operation and management of the project would also be an area of audit interest. Usually, during audit planning, the public auditor would need to be aware of the risks, their nature and magnitude, given the complexity of the PPP arrangement under review. In the course of audit, public auditors would need to continuously evaluate whether all the relevant risks were considered at the stage of project design and adequately reflected in the contract/agreement underlying the public private partnership. To what extent the identified risks have been covered under various contractual arrangements between the parties and how these were dealt with in real situations during and after the execution of the project would need to be focussed upon.

5. Prevalent roles and responsibilities of SAI-India with respect to audit of PPP arrangements

5.1 Audit mandate of SAI-India

SAI-India derives its audit mandate from article 149 of the Constitution of India which lays down the duties and powers of the Comptroller and Auditor General of India (CAG).

“The Comptroller and Auditor General shall perform such duties and exercise such powers in relation to the accounts of the Union and of the States and of any other authority or body as may be prescribed by or under any law made by Parliament ...”.
Drawing from the constitutional provision, the role and responsibility of SAI-India has been defined in the Comptroller and Auditor General’s Duties, Powers and Conditions of Service Act, 1971 (CAG (DPC) Act, 1971). Under the provisions of the Act, the audit mandate of SAI-India covers all public institutions, - the Government (as the sole auditor of the Union and State governments); public bodies and authorities; public sector enterprises (Government companies). The Regulations of Audit and Accounts (2007) lays down that audits taken up in exercise of this mandate are broadly categorised as financial audit, compliance audit and performance audit. As per the Act (section 23 of the CAG (DPC) Act, 1971), the scope and extent of audit shall be determined by the CAG.

5.2 Concerns in auditing PPP arrangements

The key motivation for Government entering into PPP arrangements is economic, - better efficiency and risk sharing along with budget neutrality. It is a mode of delivery of public service where the Government / public entity does not directly control all aspects of implementation and management. Accountability of the Government/ public entity for providing the public services, however, does not get altered because the mode of provisioning of these services have changed. Government/ public entity continues to be responsible for ensuring that public services are delivered adequately and properly and that State property, where transferred temporarily to private concessionaire, is used as intended. The onus on public audit, to assure accountability, thus continues un-altered. The challenge is to determine the terms of audit engagement in the altered scenario and chart the degree of audit necessary and desirable to provide this assurance.

The audit mandate of SAI-India encompasses the audit of all public promoters/ partners in a PPP arrangement. As such, full audit trail regarding decisions taken by the public partner in the PPP arrangement is available for scrutiny. With significant risks and responsibilities being transferred to the private partner in a PPP arrangement, access of public audit is somewhat fractured; the degree of loss of access depending on the degree of loss of control on part of the public partner which varies with the model of PPP that has been employed. For example, in management contracts, the execution risk alone is transferred to the private partner and thus the loss of Government control and therefore audit access is only to this extent; while for a DBFOT (design, build, finance, operate, transfer) agreement, the plan and design risk, financing risk, revenue risk have all been transferred to the private partner along with the risk of execution, operation and maintenance of the project leading to very significant loss of control of Government and consequent limitation of audit access.

5.3 Access to records of private partners

The access of public audit to records of private partners has been debated with some disputes having been referred to the courts. As part of Government policy, spectrum is allocated to private telecom companies for providing telecom services and these private companies have to share a part of their annual revenue with Government as license fees and spectrum user charges. The mandate of SAI-India to audit records of the private telecom company to assess correctness of Government revenue was challenged. The Supreme Court of India (in its judgement of 17 April 2014) clarified the auditability of revenue sharing arrangements:

"Parliament has an obligation to ascertain whether the entire receipts by way of license fee, spectrum charges, have been realised by the Union of India and credited to the Consolidated Fund of India (CFI). CAG’s examination of the accounts of the Service Providers in a revenue
sharing contract is extremely important to ascertain whether there is an unlawful gain to the Service Providers and an unlawful loss to the Union of India, because the revenue generated out of that has to be credited to the Consolidated Fund of India”.

The Court held that the constitutional mandate of CAG of India is not confined to accounts of the Union or the State Governments and other bodies and authorities prescribed under law by the Parliament or State legislatures “but also to audit all transactions which Union and State have entered into and which has a nexus with Consolidated Fund, especially when the receipts have direct connection with revenue sharing”. The Supreme Court judgment has given a boost to audit of PPP arrangements, particularly in cases where the arrangement involves revenue sharing with the Government/public partner.

5.4 Framework for audit of PPP arrangements by SAI-India

Audit of PPP arrangements is taken up by SAI-India based on their risk perception, materiality and significance. A set of auditing guidelines ‘Public Auditing Guidelines for PPP in infrastructure projects’ have been issued for informing and advising the objectives, scope and process to be followed for audit of PPP arrangements. The life-cycle of a PPP project would typically include:

(i) Pre-project strategic analysis which decides the contours of the PPP arrangement and includes the design, appraisal and approval of the PPP model applied to the project along with sanction of viability gap funding by the Government in case the viability of the project is in doubt.

(ii) The process of awarding the project to the private partner including transparent bidding processes, selection of the most competitive bid and entering into a concession agreement which balances the risks among the public and private partner.

(iii) Implementation of the project by the private partner which may include design, finding finances, construction, operation and maintenance of the project. It is during this phase that the private partner would collect user charges and share revenues or profit with the public partner.

(iv) Completion of the project and its transfer back to the public authority.

Full audit trail is available for studying stages (i) and (ii). There could be challenges to audit access in stage (iii) as most of the related audit trail would be available with the private partner who is not formally within the ambit of public audit. However, reports on implementation is usually available with the public partner, being submitted by the private partner as a condition of the concession agreement. Besides, the public partner often has inspection rights which could be used to access records of the private partner, if the scope of audit demands such information. The Supreme Court judgment (April, 2014) has also asserted the right of SAI-India to audit PPP arrangements which can also assist in accessing records of the private partner.

In sum, the audit of PPP arrangements is driven by the specific audit question. The audit trail for addressing the audit question may well be entirely available with the public partner. In a few cases, the audit investigation may lead to areas where complete documentation is not available with the public partner (which continues to remain the auditee for the public
auditor) and access to records of private partner becomes essential. As clarified by judicial
pronouncements, access, in such cases is not denied to SAI-India and can be enabled
through the public partner (auditee) or be asserted in public interest.

6. Audit experience of SAI-India with respect to PPP arrangements

6.1 Audit coverage of PPP arrangements

In strategic planning and in deciding the focus of audits, SAI-India follows a risk based
approach. PPP arrangements have gained currency in the country over the past two
decades. There have been significant concerns regarding this mode of project
implementation. Considering their significance, audit of PPP arrangements have been taken
up by SAI-India. These audits have covered strategic analysis of the PPP model, selection of
the PPP partner, terms of the contract governing the PPP arrangement as well as
implementation of the project being developed on the PPP mode (essentially, (i), (ii), (iii) of
the PPP life-cycle as explained at para 5.4 above; stage (iv) has not yet been audited given
that PPPs in the country are yet to reach completion stage).

6.2 Some significant audits of PPP arrangements by SAI-India

Audits of PPP arrangements have been carried out by SAI-India both at Union and State
government level. Though PPP models have been operationalized across a number of
infrastructure sectors in India, it has been most extensively employed for transportation
infrastructure; - e.g., highways, ports, airports. Accordingly, SAI-India has carried out a
number of audits in this area. A snapshot of some significant audit reports on PPP
arrangements are as below:

**Union Government**

- Performance audit of Implementation of Public Private Partnership projects in
  National Highways Authority of India – Union report no. 36 of 2014

- Performance audit of implementation of PPP in Indira Gandhi International Airport
  Delhi – Report no. 5 of 2012

- Performance audit on PPP project at Chhatrapati Shivaji International Airport,
  Mumbai – report no. 15 of 2014

- Performance audit on PPP projects in major ports – report no. 49 of 2015

**State governments**


State governments have also entered into PPP arrangements, particularly in the infrastructure sector and audit of these arrangements has been taken up by SAI-India. Recent examples are the audit findings regarding contract management of mega highway projects executed through PPP framework in Rajasthan (reported in audit report no. 2 of 2016 on State government of Rajasthan); development of port sector in Gujarat through private participation (commented upon in audit report of Gujarat state of 2016) and audit of implementation of Vizhinjam International Deepwater Multipurpose Seaport Project (commented upon in audit report of Kerala state of 2016).

6.3 Focus of PPP audits conducted by SAI-India

PPP audits have been taken up to derive assurance that the interests of the public partner in the PPP arrangement have not been compromised and that the PPP model has provided the best value for money in implementation of the project. At the same time, the quality of service being provided to the users and the interests of the public users of the infrastructure project has been kept in view by audit. Concerns regarding design of certain PPP projects have been raised in audit. The bidding mechanism has been scrutinised to derive assurance regarding its fairness and transparency. In a few arrangements, audit has noticed that the contract/agreement with the concessionaire has failed to effectively transfer the risks to the private partner resulting in additional burden on the public promoter or the user of the infrastructure/service.

Most of these audits have been carried out on the basis of information/documents available with the public promoter/partner of the PPP project (essentially an auditee of SAI-India). The trail regarding plan, design, appraisal, approval and contracting of the PPP project is entirely available with the public promoter/partner and entirely within the ambit of audit. The public partner also receives progress reports of the project, reports of independent engineers and audited financial statements of the project being implemented by the private partner which can be easily accessed. Instances have arisen where additional information, available solely with the private partner, has been found necessary for audit. In such cases, efforts are made to access these records through the public partner. Usually as a contractual provision, the public partner has the right to call for information regarding the project and the public promoter may be able to source the required information from the private partner. At times, audits of such PPP arrangements have been taken up by SAI-India at the request of the Government/public promoter as in the case of audit of hydrocarbon production sharing contracts. In this case, the agreement (production sharing contract) signed between the Government and the private licensee provided for audit and inspection rights of the Government and it was under this provision that audit of private operator’s records was conducted by SAI-India, at the request of the Government.

It must however be acknowledged that while significant audits of PPP projects can be done through audit of records available with the public promoter/partner, at times access to records of private partners become essential for addressing the audit objectives. Though access of public audit to records of private partner is not blocked in India, its extent continue to be debated and it often prolongs the audit schedule adding to the audit effort.

7. Views of PPP project management regarding audits by SAI-India

7.1 Engagement with management during audit
PPP audits taken up by SAI-India usually fall in the category of performance or compliance audits. Guidelines for conduct of these audits (Performance Auditing Guidelines and Compliance Auditing Guidelines of SAI-India) lay down a protocol for engagement with the auditee/management. The intent of taking up an audit, the objectives of that audit and its scope are informed to the auditee at the inception of audit. In case of performance audit, these are formally discussed with the auditee in an entry conference. Field audit involves close interaction with the management of the audited entity and their responses to audit queries form the basis for drawing up audit findings and conclusions. The audit report (draft performance audit report in case of performance audits; inspection reports in case of compliance audits) is duly forwarded to the management/auditee for response. For performance audits, the results of the audit are also discussed with the senior management of the auditee in an exit conference. The responses and views of the auditee/management is duly considered and reflected in the audit reports finalised by SAI-India.

In case of audit of PPP arrangements by SAI-India, the designated auditee is the public promoter/partner. Close interaction, as mandated by the performance and compliance auditing guidelines is maintained with the auditee (public promoter/partner) in all PPP audits. Though audit may need to access records of the private partner for purposes of PPP audit, the private partner does not acquire the status of an auditee of SAI-India. Audit continues to remain focussed on the public promoter/partner and the interest of the common user of the infrastructure project.

Through continuous engagement during planning, execution and reporting audit, SAI-India endeavours to inform and advise the public promoter/partner on the goals and objectives of auditing PPP arrangements.

7.2 Recommendations arising from PPP audit

SAI-India, in the course of auditing PPP arrangements, have made specific recommendations based on audit conclusions which, in audit opinion, would help improve the management of PPP projects. These recommendations have been discussed with the public promoter/partner and in most cases have been accepted by them for implementation.

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**Implementation of PPP project at Mumbai airport: Report #15 of 2014**

PAC made the following significant recommendations on the basis of the audit report:

- Review of performance be made by Ministry at regular intervals to safeguard the revenue interests of the Government as also to condition Mumbai International Airport Limited to deliver as per its committed outputs.
- Appropriate measures may be taken to ensure that incentives such as increase in base airport charges are not given when inordinate delays take place in completion of the projects for unjustifiable reasons.
- Development Fee should be determined in future keeping in view the revenue interest of the Government of India in PPP projects and also that of the interest of the passengers.
After the audit reports are tabled in the Parliament, they are referred to parliamentary committees (Public Accounts Committee (PAC) and Committee on Public Undertakings (COPU)) which examines the audit report, engages with the audited public entity, ensures suitable corrective actions are taken and also recommends better practices for future implementation. The recommendations flowing from the audit of a few significant PPP arrangements, as accepted by the Government/public promoter/public partner are summarised alongside.

8. Challenges faced by SAI-India in fulfilling their role and responsibilities with respect to audit of PPP arrangements

PPP is a relatively newer model (approximately two decades old) of delivery of infrastructure services in India. While engagement of private parties on contract had been fairly common, the complex sharing of risks and responsibilities among the public and private partner in a PPP arrangement is novel. As such, SAI-India has been on a learning curve in audit of PPP arrangements. Some of the challenges that are being faced in this audit are summarised below:

(i) Complexity of the subject: PPP arrangements are complex involving many stakeholders; - the public promoter, the private partner and the user being three of the most significant. The arrangement aims to optimally transfer and assign project risks among the public and private partner. As a PPP project remains valid over a long periods, the assumptions made at project inception are liable to change which may seriously impact the project viability. At a minimum, an auditor of a PPP arrangement is expected to appreciate the technical parameters and financial viability of the project and have an understanding of the legal arrangements (contracts and agreements operationalizing the PPP arrangement) underlying its execution. At the same time, the interests of the user and the quality of service delivered needs to be kept in view. The complexity and diversity of understanding required for an effective audit of a PPP arrangement proves a significant challenge for the auditor.
(ii) **Insufficient domain knowledge:** While audit of PPPs has considerable interest, it often requires an in-depth understanding of the business for a credible audit effort. Technical knowledge including legal knowledge is a key challenge for audit of PPPs as lack of it may adversely affect the auditor’s understanding and acceptance of audit findings and recommendations.

(iii) **Paradigm shift in the business environment:** Private organisations have a different business environment and applicable rules and regulations vis-à-vis the public set-up which is familiar to the public auditor. Applying rules/ conditions prevalent in the public sector to assess the functioning of private partners may lead to perverse conclusions and even loss of credibility in the long run. The challenge of educating and training the public auditor so that s(h)e is equipped to carry out a credible audit is more significant with the complexity and novelty that PPP arrangements pose.

(iv) **Resistance to access:** There is significant resistance from private sector (the private partner in the PPP arrangement) to providing access of its documents to the public auditor. Though audit mandate issues have been clarified through judicial interventions in India, the public auditor needs to be prepared for tactics of denial, delay, resistance, non-cooperation and outright hostility. It is a challenge to devise protocols for dealing with audit in such hostile environments.

With PPP arrangements gaining currency in infrastructure projects, the public auditor needs to rise to these challenges focusing on education and training of its staff. Multi-skilled audit teams would also be better equipped to address the complexities posed by PPP arrangements.
Federal board of Supreme Audit of Iraq, established under the law no (17) of 1927, is administratively and financially independent institution with a moral personality that helps to strengthen the economy and credibility of Iraqi government. According to its current law no.(31) of 2011 (amended), FBSA has the authorities which enhance its administrative and organizational independence to assist it in achieving the tasks and activities that FBSA seeks to submit to the audited entities.

Preparing various types of auditing reports and communicating them to stakeholders, for example legislative authority, to use such reports as auditing and accounting means on the executive authority actions is the main task of the FBSA’s work. Executive authority as well uses auditing and accounting means on the executive authority actions is the main task of the FBSA’s work. Executive authority as well uses auditing reports as auditing means on governmental ministries. Hence, it becomes clear that auditing report is the link between FBSA, as an independent audit entity, the legislative authority and the executive authority.

Therefore, special attention were paid by FBSA to ensure that such reports at high level of credibility, quality and sound in content, form and integrity in performance by auditors who prepare them and thus be the truth title. Such reports should contain binding opinions, notes and instructions to the audited entity. FBSA has constitutional mandate according to Article (73) of the Iraqi Constitution, third item of Iraqi Constitution. FBSA implements its tasks in accordance with the Law of the Federal Board of Supreme Audit No.31 of 2011 (amended).

Paragraph/4

FBSA audits and controls public money wherever it is fund.

Paragraph/13 fourth implement inspection instructions of grants, subsidies, loans, facilities, concessions and investments and verify that they are use for the right purposes.

Chapter one – legal framework for partnership contracts:

Section one – laws and legislations that govern the work of Partnership contracts:

1. The order of dissolved temporary collision authority no.(39) for 2003 – part seven paragraph (b) from (1) the foreign investor is allowed to invest by establishing joint commercial entity with an Iraqi investor.

2. The Iraqi state companies law no.(22) for 1997 (amended) allows state companies to enter into these kind of partnerships with incorporated companies, whereas the article no.(15) is stated the following:
First: the company can invest cash surplus to contribute with incorporated companies or to share with to implement works related to company’s objectives inside Iraq and to obtain the consent of the Council of Ministers if the project is outside Iraq.

Second: the consent of the Council of Ministers is obtained when investing cash surplus from Arabic and foreign companies and institutions or sharing with them to implement works related to the company’s objectives outside Iraq.

Third: the company has the right to share with Arabic and foreign companies and institutions to implement works related to the company’s objectives outside Iraq.

According to this, many public sector’s companies consider this kind of contracts as a mean to invest to finance the deficit in their budgets after the government considers privatization of public sector and offering many companies to direct investment by Arabic and foreign companies.

3. The system of branches and offices of foreign economic companies and institutions no.(5) for 1989 indentifies the following in the article (3);

First: the foreign economic company or institution that practices permanent activity in Iraq or contracted to implement a specific project should provide a written notice to the companies register as soon as it enters into the convention, agreement or contract that related its activity or project. This does not include the companies and corporations contracting to supply goods or materials unless it has real existence in Iraq or include agreement or contract for providing services of any kind.

Second – The registrar that set controls in coordination with the concerned departments, will determine whether the company or the foreign economic corporation has to get a license for a branch in Iraq within two weeks from the date of receipt of the notice.

Third – the ministry of trade has the right to grant license to open a representative or communication office for the foreign economic corporation that is not covered by the provisions of first and second paragraphs of this article after seeking the opinion of the relevant sectoral bodies.

As for article (4) of the same system it showed the following:

The company or the foreign economic corporation that subject to the license to open a branch or office shall prepare the following documents certified by the competent authorities.

First: two copies of the license application form.

Second: two copies of the memorandum of association and primary system of the company or parent corporation or its substitute.

Third: two copies of company or corporation registration certificate issued in the country of origin.
Fourth: list of company or corporation management board members names, nationality of each of them and the names of the persons authorized to sign.

Fifth: two copies of the authorization of the Director in charge of the management of the branch in Iraq who resident their in actually issued by the company or cooperation management.

Sixth: two copies of last final accounts of the company or corporation with two copies of the report of the management board annexed to or attached to these accounts.

Seventh: confirmation letter from the government departments and socialist sector contracted with, showing the contracting nature stating the commencement and completion date, total price, maintenance duration if there is for the company subject to license of opening branch only.

Eighth: any other document requested by the registrar of companies.

Chapter two - the instructions and regulations issued by the government bodies concerning the implementation of the partnership contracts and mechanism of implementation

There are multiple government bodies authorized with preparing the regulations and instructions related to facilitating the implementation and following up the procedures of concluding partnership contracts between the state companies and private Iraqi companies and Arab and foreign companies and in accordance with the nature of the activity and the ownership, starting from the secretariat of the cabinet as the higher executive arm authorized with setting regulations and instructions relating to the work of the ministries and the non ministerial government bodies and regulating it and down to the state company represented by the executive board and as shown below and which include but not limited to:

1. The Secretariat of the Cabinet:

A committee was formed under the decision no.112 for 2012, it was tasked with setting the regulations and recommendations concerning the mechanism of implementing the sharing contracts in order to develop the production and performance of the state companies related to the ministry of industry and minerals, the secretariat issued the decision no.492 for 2013 which states the following:

1st: technology transfer and developing the capacities of the state company in practicing its activity and producing new products.

2nd: To ease the burden of loans on the State.

3rd: provide new job opportunities.
4th: Achieving balance in the interests in terms of rights and obligations between the two contracting parties and creating an environment appealing for investment.

5th: Committing to prepare an integrated feasibility and technical study before the commencement of contracting procedures by an experienced and competent person and presented to the Board of Directors of the company for approval.

6th: The state company and the contracted company (the partner) work in the same activity, and the sharing contracts should be consistent with the activity of the state company and its specialty according to its internal system.

7th: Contracting with sound manufacturing or producing companies directly and the contracting with intermediate or importing companies is not allowed.

8th: The company or the Arab or foreign economic institutions is committed after signing the contract of sharing with the state companies to open a branch in Iraq or turning its office if it has an office to a branch inside Iraq.

9th: The state Company’s commitment in the conclusion of manufacturing contracts to participate in the production and not only importing the finished goods and marketing them to the beneficiaries and determine the added value of the product in the contract by not less than 15% during the first two years of the implementation of the contract, not less than 25% later, To ensure the improvement of the company’s overall performance and to improve its economic status.

10th: The contracts of sharing with the Arab and foreign companies and economic institutions are concluded in accordance with contracts that clearly define the rights and obligations of the parties, taking into account the application of the mechanisms of the contracting procedures specified in the instructions for executing government contracts in terms of preparation of the feasibility study and announcing the company’s desire to participate in improving its productive reality and developing its capabilities and procedures for opening bids and analyzing them and up to the awarding to the appropriate partner and providing good performance guarantee before signing the contract.

In addition to the above, the Secretariat of the Council of Ministers, represented by its affiliated departments, has set the procedures for contracting with Arab and foreign companies in terms of contracting, awarding, extension, letters of guarantee, etc.

2. The Guideline to execute the Council of Ministers’ resolution no.96 (2016)

Article (1) definitions

1. Partnership: It is a long-term agreement concluded between a centrally financed governmental party and local or foreign party from private sector to execute projects or provide public services. Under this contract, private sector parties bear great part of risks, management responsibility and get investment costs in away that copes with project execution.
2. **Partnership Project:** It is any investment project (service, production and consultation) concluded via partnership contract to execute or complete investment plan projects of the centrally financed entities of ministries. It aims at providing better public services through lowering the costs or increasing efficiency.

3. **Steering committee:** it means the technical committee that is concerned with registering and preparing investment projects that are qualified to be shared with private sector (formed according to the Ministers’ council resolution ( ) for 2016.

4. **Partnership projects list:** it contains the projects registered, qualified for sharing and is issued by the steering committee.

5. **Registering partnership project form:** It is a brief report on the proposed partnership project prepared by the party willing to presenting the investment project for partnership. It includes the data mentioned in article (5) of the guideline. The report is submitted to the steering committee for approval.

6. **Private sector partner:** it means the company or a coalition of local or foreign companies that bids for partnership project according to the conditions and regulations of advertisement. It should have the potentials, skills capabilities and capital adequacy; to win the project and have the project awarded to it.

7. **Partnership contract:** it is a long-term contract concluded by the centrally financed governmental entity with the private partner under such contract all commitments and contractual tasks are organized according to the Iraqi law provisions. Also, it includes all the agreements related to the contracts.

8. **Project Company:** it means the Iraqi corporation founded for a sole purpose i.e. executing partnership contract according to the Iraqi law provisions and terms of the concluded partnership contract.

**Article (2) objectives of partnership between the two sectors**

Through partnership contracts concluded between the two sectors, centrally financed governmental entities aim at the following:

First: Executing or completing investment plan projects that are suspended and qualified to be shared with private sector.

Second: Encouraging private sector to conclude partnership contracts with governmental entities in a way that improves the infrastructure, provides and develops technical and administrative experiences.

Third: providing the necessary funding to promote the governmental projects efficiency, provide better services and ease financial burdens on the government public budget and lessen the need for borrowing.
Furth: Benefiting from experiences and modern knowledge in managing, maintaining and operating economically feasible governmental projects.

Fifth: Attracting and encouraging direct local and foreign investments.

**Article (3) partnership contract types**

First: Concession agreements: under these agreements, operation and development rights are awarded to the private sector partner (including rental costs and capital and cost and investments provided that the project assets are returned to the governmental entity at the end of the concession (usually long term contract ranging from 15 to 30 years) period. Revenues are determined according to the concession agreement terms.

Second; Service contracts: under these contracts, the private sector partner executes specific tasks during the contract period (collecting fees, maintaining of vehicles and equipments, repairing roads and maintaining facilities).

Third; Management agreements; under these agreements, the private sector partner takes the responsibility for operation and maintenance and the government entity maintains ownership over the assets and shoulders the responsibility of providing services, bearing commercial risks and capital investments. It is a contract against a fixed price that depends on the management efficiency – such contact period ranges from 3 to 5 years.

Fourth: Lease Contracts; under these contracts, the private partner leases the public facility assets, is in charge of operation and maintenance and bears all commercial risks of operation works. The government agency maintains ownership over assets and the responsibility of main investments. It coordinates the investment programs with commercial programs of lessee. An organizational system of 3-5 years duration is required to follow up the lessee’s obligation.

**Article No.4: Phases of Partnership Contracts**

There are four main phases. The documents of standard bidding issued by Ministry of Planning are considered as guidelines when contract specifications preparation procedures are needed as per the following:

**The First Phase: project, Registration and Selection**

It includes the following procedures:

1. Prepare the report of investment feasibility of partnership with private sector (the report is prepared by the government party).
2. Submit the request for project registration to the Steering Committee (prepared by government agency).
3. Study and analyze the investment feasibility report and complete its qualification (the Steering Committee assumes this tasks).
4. Issue the decision of project registration (the Steering Committee)
5. Prepared and issue the project bidding documents (the Steering Committee and government agency).

The Second Phase: the Procedures of Bidding, Auction and the Selection of Private Partner

It includes the following procedures:

1. Advertise the participation invitation in the partnership contract (it is classified according to the project type and cost)
2. Analyze, evaluate the technical and financial offers and conduct the competitive discussion.
3. Select the winning private partner or the winning coalition of private partners.

The Third Phase: Contracting and Awarding Procedures

It includes the following procedures:

1. Negotiate the form of partnership contract and complete the financial and legal procedures.
2. Sign the partnership contract

The Fourth Phase: Post – Contracting performance Procedures

1. Prepare the plan of contract execution follow up and establish specialized committees.
2. Monitor the performance during the phases of contract execution.
3. Manage and follow up the review request or renegotiate the contract and supervise when conflicts occurred.
4. Supervise the contract execution till the end of contracting period.

Article no.5 the Registration and Preparation of Partnership Project

The centrally financed- government agency that wants to execute the investment project via partnership with private sector shall formally submit a request to the Steering Committee of partnership projects by a formal letter signed by the head of the entity to register the project. This is done by preparing the investment file of the project for partnership purposes according to the model of partnership project preparation and registration issued by Steering Committee of partnership projects.
Third: the steering committee shall, with the help of its international investor, study and evaluate the investment file submitted for each project and shall discuss the details via joint meetings and/or complete them in coordination and cooperation with the proposed entity to contributes to the completion of the tasks assigned.

Fourth: the guidance standards for acceptance registration of partnership projects with private sector are determined in accordance with the following.

1. The minimum commitment of private sector is to finance establish or develop targeted investment projects and maintain them as well as providing necessary services and facilities throughout contracting period.
2. The period of partnership contracts shall not be less than 3 years starting from the effective date of partnership contract.
3. Total value of partnership contract shall not less be than 3 billion IQD.
4. Payment of financial dues to the private partner shall be made once the contracting government entity issues a certificate of acceptance of the level of work or services provided under the partnership contract.
5. Public balance shall not bear any expenses or financial dues throughout the contractual period.

Fifth: the steering committee shall register the projects qualified for partnership with private sector. It shall provide centrally funded government entity with a proposed form of the invitation of the project and a sample of the partnership contract.

Sixth: government entity shall undertake procedures of advertising awarding, contracting and execution of partnership contract in accordance with the provisions of the Council of Minister decision No.96(2016).

Seventh: the steering committee of partnership projects between the two sectors shall issue consolidated unified form of the report of institutional, technical, economic, legal requirements for registering and preparing the investment project for partnership with private sector. It shall include the following bases:

1. The list No.(1) is adopted for ongoing projects that are listed in the investment plan.
2. As for the new projects, the file of investment feasibility of list no.2 will be adopted.

Chapter Two-Conclusions and recommendations.

The first topic: conclusions

1. The contracts of public companies are nominal, not based on scientific, legal and technical basis, as all companies are considered supplying or marketing or brokerage firms that lack of equanimity and professionalism.
2. The laws and instructions issued by the Iraqi legislator in the formulation, implementation and following up are not being taken into consideration, but it relied on some paragraphs in instructions and implementation of government contracts nominally.

3. According to the terms of the contracts, the purpose of sharing contracts is to achieve profit by supplying the contract materials to the beneficiaries. While in practice these contracts did not achieve their purpose, since the public companies relied on the difference between the two contracts as a profit rate not exceeding 10% in all contracts and appendixes audited by the FBSA.

4. There are many paragraphs of the contracts that have not been activated or committed to by the contract two parties represented by the public company and the foreign partner. For example without limitation to, (breach the contract terms, delay penalties, bills of quantities, the method of payments, letters of guarantee, certificates of origin, final accounts, addressing the competent government authorities to follow up contracts,...etc).

5. The concluding contracts and appendixes have not achieved the purpose. The public companies are being liable to the obligations and responsibilities set in the contracts (the preparation of production areas, warehouses, technical staff, customs exemptions, shipment and freight charges) and other for gaining a profit percentage that lacks a reasonable bases or provided in the or appendixes agreed by the two parties to meet these obligations and commitments.

6. The agreed upon contracts did not achieve any value added to public companies in terms of increasing and developing productive efficiency, rehabilitating the idle lines and out of service factories, improving the quality of products, increasing the number of production units for each single unit to meet the needs of the local market.

7. The concluding contracts and appendixes are considered nominal in terms of committing with the contract terms, the period of implementation and the quality of the supplied materials. It was noted through the issued reports there are many points of violation i.e.,(lack of the certificates of origin. The absence of maps and engineering designs, there are no participation rates between the parties, there area no specific profit criteria between the parties, amounts of financial repayments, the amount of letters of guarantee, contract period, delay penalties, lawsuits).

8. The contract parties have not complied with the central decisions issued by the competent authorities. The Ministry of Industry and Minerals was not serious about the directives, most of the Ministry’s responses were limited to supporting the FBSA’s observation without taking measures to prevent the recurrence of these observations, as set forth in our reports in attachment disclosure.
Chapter two: recommendations

1. The central parties prepare laws, regulation, rules and instructions which organize foreign, Arabic, Iraqi companies to ensure the benefit and achieve the purpose of contracts for all the parties.

2. Form the committee to review operated and concluded partnership contracts, develop binding recommendations to apply, execute paragraphs that is provided in these contracts and limit defaults and defectiveness according to regulations, rules and instructions as well as activating the recommendations of above committee.

3. Form a committee to evaluate what has been achieved from these annexes and contracts of previous periods financially and technically from 2011-2015 and determine the extent to which these of contracts and annexes area liable as well as to determine the added value of it if we know the general company provide the storage and productive space, productive lines, technical staffs, transportation, distribution, contracting and others as, direct and indirect costs as well as tax and customs exemptions to support the contracted companies to develop, transport and settle the technology, technical experiences, training and rehabilitate the employees in the general company according to general partnership contract conditions.

4. The general company are bound to apply defined regulation, rules and instructions of contracting by direct ministerial supervisory on all Stages of the conclusion and implementation contract to avoid marked observations by FBSA about these contracts which as weak procedures of following up and controlling over the companies affiliated are notices so these observations are concluded.

5. Identify profit rate agreed upon into partnership contracts on the basis of provided scientific document by general company in line with provided services of partner to be adopted as base of concluded annexes as for example the number of employees in the factories and workshops or on the base of costs centers and on fees compare with accrued amounts from these annexes and contracts as the percentage to cover these expenses.

6. The contracting companies (private companies) are bound to provide actual services to public companies in accordance with what is agreed upon and fixed in the participating contracts signed and referred to in the disclosure in the fourth section of the third chapter in term of establishment, development and rehabilitation of production lines, in order to ensure the achievement of net real profits for public companies.

7. The necessity of contracting with the sedate companies manufactured and produced and not marketed and intermediary , according to the instructions issued in respect of participating contracts to be signed in the future.
Third chapter – Disclosure of the violations indicated by FBSA

Below is a list of the most important violations indicated by the audit results of FBSA represented by the public bodies in the public companies:

<table>
<thead>
<tr>
<th>The identified violation</th>
</tr>
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<tbody>
<tr>
<td>1- The public companies concluded the sharing contracts with the companies based on article (15-third) of The Public Companies Law no.(22) for 1977 (amended). Conclusion of such contracts by these companies contradicts the nature of their activity set out in their by-law giving the fact that the activity of these companies is limited general trading.</td>
</tr>
<tr>
<td>2- The contracts concluded directly with the companies in contrary to instructions of performing governmental contracts, in which it let to lack of open competition to get the best prices and technical specifications of the contracted items. This led to additional costs to the beneficiaries, which in turn lead to higher prices of these materials.</td>
</tr>
<tr>
<td>3- The companies did not submit the technical and economic feasibility study approved by ministry of planning.</td>
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<td>4- The companies did not submit their final accounts for the last fiscal year approved by certified chartered accountant in contrary to instructions of performing governmental contracts.</td>
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<tr>
<td>5- The companies did not provide assurance of the soundness of their tax position.</td>
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<tr>
<td>6- The companies did not implement one of the methods of proposal solicitation set out in article (4) of instructions of performing governmental contracts mentioned above.</td>
</tr>
<tr>
<td>7- The lack of administrative orders regarding forming of the two committees of opening and analyzing bids and the mechanism that is going through then the bids award and the recommendations of the two committees above, contrary to article (7) of instructions of performing governmental contracts mentioned above.</td>
</tr>
<tr>
<td>8- The company did not adopt any basis, measures or ratings for evaluation and weighting to identify the best technical and financial proposal, contrary to article (5-second) of instructions of performing governmental contracts mentioned above.</td>
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<tr>
<td>9- By reviewing the documents of contracted companies, we notice that their capital did not comply with obligations assigned to them in the contract.</td>
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<tr>
<td>10- There were differences between the specifications of contracted apparatus.</td>
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<tr>
<td>11- The sharing contracts did not achieve any of the objectives set for them such as (Contribute to the reconstruction of infrastructure projects for various governmental, mixed and private sectors, transfer of modern technology in the field of project implementation.</td>
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Chapter I: Research Background and Methodology:

Research Problem

The main problem is represented in clarification of State Audit Bureau's role, in auditing the partnership projects between the public and private sectors, and determine the extent of proficiency of the advance and subsequent supervision in the supervision of those projects, and the extent of its coping with the recent technologies and following the information systems in surveillance, follow-up and supervision on the concluded contracts with the companies.

We will broach in this research the extent of the integrated cooperation between the advance and subsequent supervision during examining the various projects, does such a cooperation really ideal and perfect, and move to aspirations and hopes level to protect and control the public money.

We will also clarify how much attention of supervision on the performance that is in a parallel and equal line to the advance and subsequent supervision on the governmental projects within the partnership projects between the public and private sectors.

Hypothesis:

1. State Audit Bureau's supervision is not enough and does not cover all the execution phases of the partnership agreements between the public and private sectors.

2. Presence of default, lacking to take into consideration the notices of State Audit Bureau on the governmental contracts in general, and not taking the prior approvals in this regard.

3. The approach of the supervision is still traditional, and is not coping with the recent technological developments.

4. The governmental routine and lack to provide the State Audit Bureau with the necessary documents for examining have negative effect on the quality of audit and supervision upon the projects within the partnership agreements between the public and private sectors.

5. Lacking of complete cooperation between the advance supervision and the subsequent supervision in the various phases of the project.

6. Lacking of the sufficient knowledge of some of State Audit Bureau's auditors with the types of partnership projects and the problems and obstacles, which face it.

Importance:

Clarify the importance of the partnership projects between the public and private sectors, and its great financial and economic effect on the State general budget and the effect of supervision upon it.

As well showing the urgent needs for auditing on the partnership agreements, between the public and private sectors in Kuwait, due to increasing the rate of the mutual projects between the two sectors, and the necessary to find a unified and advanced approach to rationalize the governmental spending, and seek to apply the recent, and international
directions in supervision upon the governmental projects such as the performance supervision.

**Objectives:**

1. Identify the applied legal framework in State of Kuwait to manage and regulate the partnership agreements between the public and private sectors.

2. Identifying the State Audit Bureau’s role in supervision upon application of the partnership system in the projects, and evaluating the resulting effect of that partnership and the extent of its achievement of the required objectives.

3. Clarifying the audit types, which the State Audit Bureau perform them and the extent of cooperation between the advance, subsequent supervision and the performance supervision on it.

4. Illustrating the role of law No. 116 of 2014 in regard to the partnership projects between the public and private sectors - in setting the legal basis and the procedures that must follow it, when presenting one of the partnership projects in which the explanatory note of this law came with details that indicate the mechanism of presenting and executing the projects, and illustrating the role of the public authority of partnership in the companies setting up process whether the national or the foreign.

5. Clarifying the types of partnership contracts between the public and private sector and the field of applying this type of contracts, which increase by the rising of the rapid technological and economic development.

6. Demonstrating the most important risks that facing the State or the private sector in the partnership contracts, and the mechanism to control/limit it since applying a private reference of distributing the risks at presentation of every project leads to reduce the possibility of its occurrence, therefore the time, money and effort will be saved in the project.

7. Identifying the challenges and obstacles that face the State Audit Bureau during performing the auditing on the partnership agreements between the public and private sectors, and contributing to apply the solutions for these challenges.

8. Contribution in sharing the concept of partnership projects and its types, fields, objectives and its economic and financial effects.

**Research Methodology:**

This research will follow the documentary method, which is represented in the historical information and data concerning the auditing on the partnership agreements between the public and private sectors.

This research also follows descriptive method by using the case study approach to identify closely the most important obstacles that face the projects within the partnership agreements between the public and private sectors to find the ways to overcome these obstacles.

**Research Limits:**

**Spatial borders:** the domain of the research will be in State of Kuwait only by its various laws and regulations in the subject, and the supervision role of the State Audit Bureau.
Time limits: during the period of 2010 until 2016.

Summary of Findings and Recommendations:

Findings:

1. The unclearness of development aims of the partnership process in Kuwait.
2. The variety of the governmental developments which are responsible of the projects as well as the absence of coordination among them, this can lead to the difficulty of supervision control on them and identifying the responsibility.
3. The absence and weakness of the role played by the governmental developments in detecting the application of conditions, specifications and the technical needs of some projects in accordance with the signed contracts for protecting the state rights as well as the public funds.
4. The negligence of the governmental departments to the practical measures by which they can oblige investors on a complete commitment to the contracting conditions, in addition to the non-commitment of many companies to execute the development elements of the projects as well as the additional proposed components made by them after nominating them for the projects, although those components are considered basic elements for evaluating tenders on which those projects are based.
5. The delay in implementing some projects can lead the state to lose big opportunities.

Recommendations:

1. Limiting the highlights and the desirable developmental goals of the partnership process with the private sector. Not only on the economical level or improving the public services but also on the effect of this on the developmental as well as the relationship of such partnership with the improvement of the suitable circumstances.
2. Forming a committee inside each governmental directorate specialized, in executing all the special tasks of the partnership projects, and it should be a link between the public authority of partnership projects and the governmental directorate, which owns such projects, and it must have the right to get help from foreign experiences for getting the benefits of this field and to ensure the utmost possible benefits with exchanging experiences.
3. Limiting the main frames, which can specify role of each partner in the development insuring the efficiency of coordination and the integration of all parts.
4. Providing a supervision system to ensure the commitment of all the contracting agreements between the state and the private sector on one hand, on the other hand it should ensure providing the citizens with all services on a good level.
5. Providing a database of the desirable, which need partnership, and setting its time limit programs, which can cope with the developmental plans of the state.
6. The importance of training the concerned governmental parts of the partnership with the private sector on a basis of preparing the needed studies effectively and as
soon as possible in a way that ensures the success of the negotiations between the state and the private sector.

7. The concerned parts should be aware of the problems and obstacles, which Face the partnership contracts and analyze them as well as discussing the ways of solving them to avoid them in the future.

8. Studying the successful experiments of the other countries concerning the partnership with the private sector and evaluating their advantages at the same time avoiding their disadvantages.

9. Forming a specialized unit in the accountancy council for previous and subsequent supervision to check the partnership contracts in order to be as a base for a supervisory system containing the planned laws and rules of such contracts so they must cope with the size of big future projects.

Introduction

The public-private partnerships (PPP) has played a significant role to boost the undergoing processes of national economic growth, and develop social infrastructures including roads, facilities, buildings, public services such as health, utilities, education, and sanitation, etc. It has normally been driven at the situation of the significant gap between available public funding and required expenditure, especially as in an era of rising national dept. and budget deficits. In the context of the global financial turmoil we are facing, PPPs play the role of economic stimulant in developing countries and sustainable growth in global, although the difficult economic environment substantially affected the international project finance market.

The government also seeks it to increase the quality and efficiency of public infrastructure and services in general. Expanding the use of PPP would enable the government to provide needed public infrastructure while minimizing both short- and long-term expenditures, and to capitalize on the private sector’s management skills, expertise, experiences, innovation, and alternative methods of funding.

This can also have a significant impact on international commerce. Therefore, the PPP has a number of benefits to both in markets and countries.

Therefore, the GCC and some other MENA countries are much further along the PPP experience curve than would appear on the surface. The region has completed over 100 projects on a PPP basis over the last 10 years.

A majority of countries in the MENA region have demonstrated successful Record of accomplishment in the power sector and a cumulative of $48 billion worth of Independent Water and Power Projects were completed on Build Own Operate ("BOO") or Build Own Operate and Transfer ("BOOT") basis. Saudi Arabia is building a second airport on a Build Transfer and Operate ("BTO") basis. Others, such as Jordan are also getting more active in this space. Some territories, which did not use PPP before, are now experimenting with this model.

There is, however, one caveat to the MENA story.

The region, though successful in using PPP extensively in the power sector has not been able to replicate similar success in other infrastructure sectors.
The MENA region stands at a critical stage in its development. A host of forces is shaping the MENA infrastructure investment landscape.

Firstly, there is a huge need for infrastructure investment going forward. According to the World Bank, in order to sustain its economic growth and global competitiveness, the MENA region needs to invest $75 billion to $100 billion annually on infrastructure. Moreover, GCC cannot afford to step away from its diversification drive and needs to continue investment in non-oil and gas sectors. Other MENA countries have a critical need to upgrade their infrastructure to address past underinvestment and new demand. Secondly, the ripple effects of the global financial crisis will continue to be felt throughout the region. This has resulted in added constraints on public sector’s fiscal capabilities, especially in the non-oil economies of the MENA region. Thirdly, the Arab Spring has presented a new set of economic challenges. These challenges coupled with business disruption emanating from the unrest have further exacerbated the infrastructure shortfall and made it imperative for the governments to make efficient infrastructure investments for meeting their citizens' requirements and employment generation for the young workforce.

PPP is poised for a strategic place in the MENA region. With the establishment of dedicated PPP units in Kuwait and Egypt, drawing of PPP law in these countries, and use of PPP in other core infrastructure sectors (in addition to power); PPP is graduating to the next level of sophistication.

Chapter II: Legal framework in place for governing and regulating the PPP arrangements in Kuwait

In the last few years, government of Kuwait has stepped up efforts to liberalize the economy and attract foreign investments. It has commenced privatization of some governmental owned establishments with the enactment of Law No. 6 of 2008, which is the law that governs the privatization of Kuwait Airways.

Law No. 7 of 2008 (Public-Private Partnership (PPP) Law) which amends parts of Law 105/1980 is aimed at encouraging foreign companies to invest in the growth and infrastructural development of the State. Recently, Privatization Law No. 37 of 2010 was enacted. In 2009, following the global economic crisis whose negative impact was felt in Kuwait, the government enacted the financial stimulus law (Law 2 of 2009 on Enhancing Economic Stability in Kuwait). This law was put together in an attempt to stabilize the financial sector, support local economic activity and encourage financing to local economic sectors by banks. The law therefore provides for several kinds of financial and economic stimuli intended to promote financial stability and improve economic conditions.

Proper implementation of all laws that affect directly and indirectly on foreign investments and the provision of a conducive enabling business environment in line with global acceptable practices are keys to growth and development of the State of Kuwait and
it is hoped that the Kuwait investment climate would become more attractive to the foreign investor.

In mid-2014, Kuwait passed the New PPP Law. However, other than the introductory provisions, the New PPP Law did not come into full force and effect until the publication of the law's executive regulations (Implementing Regulations) which took place on 29 March 2015.

The legal framework under the New PPP Law is aimed at overcoming challenges faced to date in procuring PPP projects in Kuwait, clarifying the law, and bringing it better into line with international standards.

The old PPP law (Law No. 7 of 2008) (Old Law), which is now repealed by virtue of article 45 of the New PPP Law, set out a framework for PPPs but was subject to a number of issues, including:

- IPO requirement for public joint stock companies, with issues related to timing of the IPO and unsubscribed shares;
- Restrictions that limited an investor's ability to grant security to the project's lenders; and
- A restriction on the amendment, renewal or extension of a project.

The New PPP Law seeks to address these issues and to embody the lessons learned from the recently closed Az-Zour North independent water and power project phase 1, to provide a roadmap for the implementation of future headline projects in Kuwait. The New PPP Law is also designed to attract more private sector investment into Kuwait.

The New PPP Law places an emphasis on the principles of transparency, openness, freedom of competition. In addition, equality of opportunities, all of which will be welcomed by investors. This over-arching philosophy translates into more investor-friendly provisions in the New PPP Law, particularly in relation to attracting financing.

The Old Law inhibited the use of non-recourse or limited recourse financing in some respects: prohibiting mortgages on project company assets and limiting assignment rights; undermining the ability of lenders to take viable security packages; and restricting the use of lender direct agreements. In a significant step towards making Kuwait PPP projects more attractive to foreign investment, Article 23 of the New PPP Law affords rights for an investor to grant security over the project contracts and assets to lenders, including a share pledge within the first two years.

New Higher Committee

The Higher Committee is the main decision-making body responsible for PPP projects in Kuwait. Article 2 of the New PPP Law provides for the establishment of a new Higher Committee for Public Private Partnerships (PPP Higher Committee), replacing the previous Higher Committee for Projects.

The constitution of the PPP Higher Committee is similar to its predecessor but its powers are broader. Its powers include approving the procurement of projects on a PPP basis, including approving the feasibility study for a project, requests for the allocation of land for a project, and the PPP contracts for a project, as well as deciding upon the request of a
public entity to terminate a project in the public interest. The Minister of Finance must ratify the decisions of the PPP Higher Committee before they can take effect.

**New public authority**

Under the New PPP Law, Kuwait Authority for Partnership Projects (KAPP) has replaced the Partnerships Technical Bureau (PTB), which was previously the main body responsible for implementation of PPP projects in Kuwait. KAPP is expected to have greater autonomy and authority than its predecessor, while its staff and assets are expected to remain broadly the same. KAPP will be supervised by attached to the Ministry of Finance and overseen by the PPP Higher Committee.

KAPP’s main responsibilities are largely similar to those of its predecessor, PTB. However, notably, KAPP will have the power to establish public joint stock companies for the performance of PPP projects. At a stroke, this helps solve one of the main difficulties experienced with the old law. In addition, KAPP’s powers include assessing feasibility studies for PPP projects; developing contract templates; drafting RFPs and PPP agreements; submitting recommendations to the PPP Higher Committee; following up on the implementation of PPP projects; and preparing a new guidebook for PPP projects.

**Leveling the playing field for foreign companies**

As well as providing a more beneficial financial framework for investors, the New PPP Law includes provisions for foreign investors to compete on a more level playing field with Kuwaiti companies. Article 34 of the New PPP Law lifts foreign ownership restrictions permitting project companies to be foreign-owned. Further, the automatic prequalification for Kuwaiti stock exchange companies that applied under the Old Law has been dispensed with under the New PPP Law.

**Procurement of the project company**

The New PPP Law provides a simpler approach for establishing the project company, addressing potential difficulties under the Old Law as to the timings of the incorporation process and who is responsible for its incorporation.

The general framework under the New PPP Law is:

- If the total cost of the PPP is not expected to exceed KW$60m (approximately US$205m), the investor must establish the project company;
- If the total cost is expected to exceed the KW$60m threshold, KAPP must establish a public joint stock company; and
- similar to the Old Law, the PPP Higher Committee will have the power to implement development projects of a special nature by way of a private project company (to be established by the investor), provided the value of the project does not exceed KW$250m (approximately US$860m). Under the previous regime, this power was sparingly used.

For project companies that are required to be public joint stock companies, under the New PPP Law the shares must be allocated as follows:

- six to 24 per cent of shares to be held by project public entity (ies), with KAPP holding the shares on their behalf until the project company is operational.
• a minimum of 26 per cent of shares to be held by the successful investor, subject to a maximum of ten per cent being allocated to the initiator, if any; and
• 50 per cent of shares to be allocated for an IPO by Kuwaiti nationals, with KAPP holding the shares on their behalf until the project company is operational.

As stated above, under the Old Law, the timing of the IPO (during the period between financial closing and commercial operation) was a key concern and this has now been addressed. Moreover, the Old Law also provided that if the Kuwaiti public did not subscribe to part of or all of the shares offered under the IPO, then these shares, or the unsubscribed parts, would be auctioned to potential private investors. This could have led to investors unexpectedly being required to subscribe for more equity than they had budgeted. This issue has also been resolved in the New PPP Law. Under the New PPP Law, if the Kuwaiti public fails to subscribe for all or part of the shares allocated for the IPO, such shares shall remain registered in the name of KAPP on behalf of the state until their disposal.

The share allocations under the New PPP Law are similar to those under the Old Law. However, the definition of project cost has been amended from total cost of a project to capital expenditure for implementing a project or preparing it for operation, which in theory could reduce the calculated value of a project for the purposes of determining whether a KWS60m threshold may apply.

Consistent with the IWPP law, the requirement for board members to hold shares in the company (as required under Decree No. 25 of 2012 regarding Kuwait Commercial Company Law) has been waived by the New PPP Law until a project company’s shares are listed on the Kuwaiti stock exchange. This will remove any restrictions on the number of board members and will allow technical board members to be appointed without them having to be also a shareholder for the construction period of the project term.

**Procurement process and project agreements**

Under the New PPP Law, previous restrictions on being able to negotiate the PPP agreement have been removed. The New PPP Law provides that contractual terms (other than those terms considered non-negotiable according to the RFP) may be negotiated. This will strengthen competitive dialogue.

The New PPP Law expressly permits arbitration as a form of dispute resolution and removes the previous restriction on amending the PPP agreement during the project term. The PPP agreement may be amended if there are unforeseen circumstances – both welcome changes to investors.

The New PPP Law also allows investors to establish potential projects for a term of up to 50 years. The previous ambiguity of whether a 20-year restriction on leases under the State Properties Law (Law No. 15 of 1980) applied to PPP projects has been removed, as the New PPP Law clearly states that the usufruct period will be equivalent to the period of investment.

In keeping with the Old Law, project facilities and the site must be handed back to the Kuwait Government at no cost to the Government upon expiry of the project term. Moreover, under the New PPP Law, if an investor participates in the retendering of a project, they get a preference of five or ten per cent of the best proposal price, such percentage being dependent on whether it is a public joint stock company or not.
Finally, the Implementing Regulations provide that the terms of references for projects (i.e. RFPs) will include privileges that may be offered to the successful investor. These may include exemptions from income tax, other taxes and customs fees, with the aim of encouraging investment in Kuwait.

**Ongoing projects or procurements:**

The New PPP Law provides that projects already signed under the Old Law can continue under the existing regime. However, there is no interim legal framework for PPP projects that are already in the procurement stage but not signed.

The procurement of PPP projects where the procurement process has already commenced but not been concluded should therefore recommence and secure the approval of the PPP Higher Committee. Practically speaking, this may result in the redrafting and rerelease of some procurement developed under the old regime documentation.

It is hoped that the new regime will open the door for the procurement, development and implementation of a greatly increased flow of PPP projects in Kuwait.

There are a number of ambitious projects in the pipeline that have been announced by KAPP, including:

- Al-Zour North Phase 2 IWPP.
- Al Abdaliyah integrated solar combined cycle plant.
- Al Khairan IWPP.
- Umm Al-Hayman wastewater treatment plant.
- The Kuwait Schools Development program.
- The Kabd municipal solid waste facility (a waste-to-energy project).
- The Failaka Island development.
- Abdullah Alahmad Street commercial/recreational Centre.
- Rest houses and Doha chalet centers.
- The new physical medicine and rehabilitation hospital.
- The South JahraLabor city (the first city to house expatriate labor).

The New PPP Law and its Implementation Regulations are a positive step for Kuwaiti PPPs, and resolve a number of the challenges that were present under the previous regime. We hope the new regime will provide the foundation for a more investor-friendly and streamlined PPP landscape to flourish in Kuwait.

The Kuwaiti Public Private Partnership Law (the Law) which had been published in 2014 and accompanied by Executive Regulations earlier in the year, seeks to promote investment opportunities and provides certain tax benefits and exemptions for foreign investors in the Public Sector in Kuwait.

Potential taxation benefits under the Law include income tax holidays and exemptions from customs duties. The Law provides general guidelines with respect to the project procurement procedures, details relating to incorporation of the Project Companies as well
as Consortium Companies / bidding companies and information related to investment terms and transfers of the Project to the Kuwaiti government at the conclusion of the PPP.

In detail

The Public Private Partnership Law - Law No. 116 of 2014 -provides for the formation of a new Higher Committee ("PPP Higher Committee") and Kuwait Authority for Partnership Projects ("KAPP").

The PPP Higher Committee will be engaged in granting approvals on recommended PPP projects, the feasibility studies submitted for PPP project, submitting requests for allocating the land required for PPP Project etc. In addition to the above, the PPP Higher Committee also undertakes the powers and functions of the KAPP board of directors.

Further, the KAPP formed under the jurisdiction of the MOF and the PPP Higher Committee, will also be responsible for establishing the public joint stock companies, carry out the PPP Projects, assessing feasibility studies, developing draft agreements and templates for the projects, submitting recommendations to PPP Higher Committee and following up on the execution of PPP Projects.

Benefits for foreign Investors

Similar to the Law No. 116 of 2013 i.e. the new Foreign Direct Investment Law, Article28 under the Law also provides for various incentives, exemptions and benefits to the foreign investors as provided in the Foreign Direct Investment law, which interlaid, include the following:

- The possibility to own up to 100% share capital of a local Kuwaiti entity, generally where the total cost of the project does not exceed KWD 60 mn (as outlined in more details below).
- Exemption from corporate income tax in the hands of the foreign investors for a limited duration of up to 10 years.
- Exemption from custom duties subject to adherence to the restrictions provided with respect to the usage / disposal of the imported machinery, tools, equipment, spare parts, merchandise, etc.

Kuwaiti Public Private Partnership Law

Necessity to have a Consortium / bidding Company

The Law specifically provides that where the project is awarded to any Consortium, such consortium shall establish one or more consortium company (ies) in Kuwait and the Partnership agreement may not be entered into until such Consortium Company (ies) has been established.

Capital holding limitations

The Law provides that if the total cost (capital expenditure) of a PPP project is expected not-to exceed KWD 60 MN, a successful investor can establish a project company, where the investor may hold the entire share capital of the project company.

However, where the total cost of the project exceeds KWD 60 mn, the KAPP is required to establish a public joint stock company, the shareholding structure of the same shall be determined as follows:
• 50% - Issued to Kuwaiti nationals listed in the Public Authority for Civil Information, by way of an IPO;

• 26% and above - To be held by the successful investor, where a maximum of 10% can be allocated to the initiator; and between 6% to 24% to be held by the Public entity(s) or the KAPP, until the PPP Project is operational.

**Finance and other items**

If the MOF accepts a Project proposed by a potential investor, we summaries below a few key benefits that would be provided to the investor, in accordance with the Law:

• Right to invest/use State-owned property - Article 1 provides investors’ the usufruct right to invest and use State-owned property to implement, build, develop, operate or rehabilitate a service or an infrastructure project.

• Extension of the contract term - Article 18 now provides the contract term on an investment project could be drawn up to maximum of 50 years; and

• Choice of finance - Article 23 of the Law permits the investor or the Project Company to mortgage/use as security any assets owned by the investor or the Project Company in order to finance the project. In addition to this, the investor is also permitted to pledge its share of the Project Company or the consortium company for financing the implementation of the Project with the prior approval of the Higher Committee.

Finally, it is worth noting the Executive Regulations to the Law issued by MOF provide guidance on further legal aspects and compliance requirements of the Law.

**Existing Projects**

Following are example sectors for which Projects are at various stages:

• Transportation;
• Real Estate Development;
• Power;
• Health;
• Education;
• Water & Wastewater Management; and
• Solid Waste Management.

To take advantage of these important updates to the Law placing effort into the strategic planning and bidding for relevant PPP projects addressing, the requirements and the incentives is clearly an important first step.

**The proposal of the idea of partnership projects and the mechanism of its credibility:**

The proposal of an idea of establishing any partnership projects between the public sector and the private one could be submitted by a real or fictitious person whether he is Kuwaiti or non-Kuwaiti. This can be done by a preliminary feasibility study for the project, which should go along with the state strategy and its development plan.
On the other hand, the article no.2 of the law no.76 in 2015 has issued the executive regulations of the law no.116 in 2014 concerning the partnership between the public sector and the private one. It states that the proposal of implementing the partnership projects between the public sector and the private one should be followed by one of the following managements:

1. The public managements: The public management, which has the desire to suggest any specialized projects according to the basis of partnership, should apply for the authority accompanied with the full feasibility study of the project according to the regulations of the law, the implementation rules and the guidance directions.

2. The high committee: Agreeing on the demand of the concerned public management for submitting one of the projects according to the partnership system and suggesting the partnership projects to the public management.

3. The private sector: The private sector must submit some ideas which should contain a preliminary feasibility study to the authority and it should meet the authority demands to execute the project and credit its submission according to the laws.

The authority should co-ordinate with the public management the overview of the feasibility study in order to pave the way for transforming the suitable recommendation to the high committee.

The authority might have the right to prepare integral feasibility study for the projects and the documents of its submission and in all conditions; the authority has the right to ask for the consultant management help and the foreign and local specialized offices, which are suitable for this purpose according to the laws and rules.

After the high committee approval on the credit idea of the partnership project, the public authority of the partnership projects form a committee called the competitive committee for each project based on the partnership.

This committee consists of at least one member of a degree not less than an assistant under secretary in the public management of a specialized field in partnership projects by which the legal, technical and financial experiences are available for the other members. This committee should be specialized in reviewing, fulfilling, or preparing the project study with its credited documents and it should be specialized in posing the financial and technical offers and the supervision of the scheduled public session for opening the financial envelopes of the technically accepted offers.

After that, the public authority for the partnership between the public and the private sectors must send the results of the integral study either the completely prepared one from the competition committee or from the private sector or from the public management accompanied with its recommendations of crediting the project, and submitting it according to the partnership system, and then the higher committee issues a decision concerning the projects offered by the authority.
Chapter III: The types of PPP projects:

At the center of every PPP lies a Contract defining the nature of the partnership between the private and the public sector. These can take very different forms and range from a fairly simple contractual arrangement such as the supply of a specific service (garbage collection, for example) to complex arrangements to design, construct, operate, maintain, finance, and provide an infrastructure service (a new airport, for instance). Each form corresponds to a given set of Public Sector objectives/priorities; an important part of the PPP design is to ensure that such objectives are identified and that the best structure is selected, then adapted to fit the specifics of the Project.

Provided below are some of the common structures in PPPs:

**Service Contracts:** With a service contract, the Public Entity retains ownership and control of all assets and properties. It awards to a private party the right and obligation to perform specified service(s) for a relatively brief period, typically one to three years. The private party may be required to furnish equipment and fixtures (such as construction equipment, tools, or computers) to perform the service during the tenure of the contract, but is not expected to invest in assets. *1*

1. **Management Contracts:** A management contract generally transfers more risk to the private party than a service contract. It passes more managerial decision-making authority to the private party over a broader range of services. This gives the private party a greater degree of responsibility and control over public facilities and more interaction with the Public Entity than would be the case with a simple service contract. The private party is not expected to invest in facility improvements, but may be responsible for specified levels of routine or Preventive maintenance. Management contracts are usually awarded for 3–5 years.

2. **Lease:** A public facility leasing arrangement, to be considered a public private partnership, is a contractual mechanism whereby a private sector service provider becomes the asset manager of an existing publicly owned facility or acquires land for its own exploitation. Under this arrangement the private leaseholder, or operator, pays a specified lease payment to the Public Entity and operates the facility or develops the land. The operator collects the authorized tariff from the users and earns profits generated by increased operating efficiencies. The private party is generally not expected to invest in facility improvements (unless it is land development), but may be responsible for specified levels of routine and periodic maintenance. A lease contract can be anywhere between 5–15 years.

3. **Standard International BOT variants:** These are contractual arrangements whereby the private party undertakes the financing and construction of a given infrastructure facility, as well as its operation and maintenance, to achieve specific outputs, outcomes, and service levels prescribed by the public sector.15 The private party usually transfers the facility to the public sector at the end of the fixed term. Normally, when the public sector simply provides land and does not specify
outputs, such a transaction is considered more of a lease than an international BOT. The common variants of this type of PPP scheme are:

- **Build-operate-and-transfer (BOT).** This is a contractual arrangement whereby the private party undertakes the financing and construction of a given infrastructure facility, as well as its operation and maintenance. The private party operates the facility over a fixed term, during which it is permitted to charge facility users’ appropriate tolls, fees, rentals, and charges (but not exceeding those proposed in its bid or as negotiated and incorporated in the contract) to enable it to recover its investment objective and its operating and maintenance expenses. The private party transfers the facility to the Public Entity at the end of the fixed term. Conditions are sometimes included in the PPP Contract to ensure skills transfer to local operators to enable them to take over the service after this period.

- **Build-lease-and-transfer (BLT).** This contractual arrangement authorizes a private party to finance and construct an infrastructure or development facility. Upon its completion, it would turn the facility or infrastructure over to the Public Entity concerned. This is done through a lease arrangement for a fixed period, after which the Project facility is automatically transferred to the concerned Public Entity.

- **Rehabilitate-operate-and-transfer (ROT).** This is a contractual arrangement whereby an existing facility is turned over to the private party to renovate, remodel, refurbish, or rehabilitate, and to operate and maintain for a franchise period. At the expiry date, the ownership of the facility is returned to the Public Entity.

- **Design, Finance, Build, Operate, and Transfer (DFBOT).** Here the Public Entity defines the service or output required and invites tenders for the complete design, financing, and construction of an infrastructure facility by a private party that builds the facility, assuming responsibility for cost overruns, delays, and specified performance risks. The private party will subsequently operate the facility to specified standards on behalf of the implementing agency under the terms of the agreement and eventually return the asset to the concerned public sector agency.

4. **Concession:** A concession is a long-term contractual arrangement similar to DFBOT whereby the private party completely takes over all aspects of management and operations of an existing facility from a Public Entity. This includes maintenance, specified rehabilitation, and capital investment in facility upgrades and enhancements, as well as raising capital for such upgrades and enhancements." The private party pays agreed concession fees to the Public Entity for the rights attending the concession. The Public Entity may also require a share of profits from its partner.

Over the past years, Kuwait’s economy has experienced one of the fastest growth rates in the GCC and has the second lowest unemployment rate.

**Sectors in which PPP projects have been undertaken:**

In the MENA region and in 2008*, the country ranked the highest in the Middle East on the UN’s Human Development Index. Kuwait has also exhibited strong economic and fiscal performance, and the government is going further to invest in vital reform and development projects/programs to transform the role of the government from an operator to a regulator and the most sectors in which PPP projects have been undertaken are:
Energy projects:

- **Al Abdaliyah Integrated Solar Combined Cycle (ISCC):** The Abdaliya Integrated Solar Combined Cycle Project will develop the first solar thermal power plant in Kuwait. The total capacity of the power plant will be 280 MW, with a solar contribution of 60 MW. The plant’s utilization of solar energy will contribute to fuel saving. An additional environmental benefit is that annual CO2 emissions will be 48,000 tons less than that emitted in a conventional plant of comparable capacity. The plant will provide services more efficient than that of a conventional combined cycle power plant, with stable continuous power generation. The Project involves the development, design, engineering, construction, operation, maintenance and transfer.

- **Az-Zour North IWPP (Phase 2):** The Project is a complex of power generation and water production, which is expected to be developed in five phases, and it involves the development, design, engineering, construction, operation, maintenance and transfer.

- **AlKhairan IWPP (Phase 1):** An Independent Water and Power Producer (IWPP) Project is being planned to generate power with a minimum capacity of 2500MW through a Conventional Thermal Steam Power Plant (using Low Sulfur Fuel Oil -LSFO, Gas Oil, Crude Oil and /or Natural Gas).

Real Estate Development projects:

- **Services and Entertainment Center – Egila:** The project involves the development of a top-notch services and entertainment center in the Al-Egaila Area.

- The primary objective of the project is to meet the existing demand for commercial and entertainment outlets in the area surrounding the project site, to minimize residents' need to seek required services in nearby districts/governorates.

- **Commercial, Educational, Cultural and Entertainment Center in Abdulla Alahmad Street:** The project will provide state of the art cultural, entertainment and educational facilities available for residents and visitors to Kuwait. In addition, the Project will boost growth of tourism and the economy as a whole.

- The concession contract will be for 30 years after which all assets will be transferred to the Government.

- **Rest Houses and Doha Chalet’s Service Centers:** The State of Kuwait, through the Partnership Technical Bureau (PTB) in collaboration with Kuwait Municipality (KM) is planning to develop 17 rest houses and 2 chalet service centers as a PPP project. The project intends to provide quality services for highway and causeway users in remote areas where services are unavailable.

- **South Al-Jahra Labor City:** The South Al-Jahra Labor City project involves the construction, operation and transfer of a 1,015,000-m² Labor City, which will provide adequate and affordable housing for 20,000 male, bachelor, expatriate workers. The project will incorporate all aspects of security,
health, entertainment while maintaining consistency with the cultures and traditions of this considerable category in Kuwaiti society.

- **Water and wastewater management projects**:
  - Umm AL Hayman WWTP: The objective of the project is to mitigate the negative impact of the increasing discharge of raw wastewater into the environment by establishing an upgraded and larger capacity WWTP that will treat collected wastewater and produce an effluent suitable for landscape irrigation.

- **The transportation Sector**:

- **The railways network in the state of Kuwait**:
  - This project of the railways network consists of an integral network to join Kuwait city, the Kuwait international airport, the marine ports and it joins Kuwait state to the other G.C.C countries. This project extends to 511 Km (both sides). This project will serve passengers, cargo, considering the lowest speed of such trains will reach 120 KM/h and reaches 200 KM/h for the utmost speed.

**Factors responsible for preferring particular types of PPP arrangement:**

We have noticed from the above mentioned that there is a big difference in the PPP contracts, some of them are simple and others are complicated specially the contracts which include the works of designing, construction, maintenance and infrastructure services. Therefore, each form of PPP contracts is different in aims and priorities, which are offered by the governmental sector and these, are the factors by which we prefer certain kinds of contracts:

1. The nature of service presented by the private sector and the readiness of the public sector, so there should be a link between the organized frame of the private sector, works, budget and collecting incomes and the nature of service that will be offered within the PPP contract.

2. The financial efficiency and the availability of market experiences, when the private sector has enough experience and the financial growth, it is easy to make it responsible for undertaking technical and financial risks.

3. The previous achievement of the public sector in the field of similar contracts made it easier to the private sector to face a new experience like the one, which proved success in the past, or the private sector decides not to undertake such experience because of its disability in facing an experience proved to be failed in the past.

4. “The quality is in return for money, risks should be undertaken by the better part which is able to manage it sometimes, and the quality may not be achieved in return for money as a result to the transformation of risks to the private sector. These risks can be undertaken by the public sector or transforming them to the private sector in cases of the failure in achieving such risk”. *

5. The ability of affording costs and to be acquainted with the budgets of public sections may help in specifying the ability to face a certain type of PPP or not, take for example the governmental sections to sign contracts of building, operating and property transmitting to build a hospital when it is difficult to use its budgets. Where they can define payments according to its financial ability for some years as to the partner of
the private sector, he can return the money invested with the reasonable profits during a limited period.

Chapter V: Ascertain the general risk situations faced by the State for identified PPP arrangements:

Risks in the PPP arrangement:

In a PPP project, the private sector is often considered to provide greater efficiency than the public sector, when managing infrastructure projects and delivering infrastructure services. Involvement of the private sector has the potential to increase operating efficiency by making investments in new technologies, bringing innovative solutions, and encouraging more transparent organizational structures.

However, the PPP projects always come with a baggage of risks associated. Hence, it becomes imperative to assess the main risks and how they can be mitigated.

Key to ensuring value for money benefits in PPP projects is an optimal sharing of responsibilities and risks between the public and private sectors. This does not mean all responsibilities and risks should be transferred to the private sector. Indeed, if the private sectors were asked to be responsible for activities and risks that it has no control over, it would increase the contract costs to Government, resulting in poorer value for value for both the Government and the private sector.

“The risks may be allocated according to each party’s expertise in managing and mitigating the risks in the service delivery process. Typical risks that are allocated to the private sector include design, construction and financing risks. On the other hand, the public sector may take on political and regulatory risks, while other risks such as demand, revenue risks will be assigned to whichever party is best able to bear it.”

Risks in the conception stage of PPP arrangement:

Political and Economic risks

PPP projects require governments to accept that greater equity participation in projects is more likely to be necessary and that the changing financial environment needs to be reflected in the contractual relationships between governments and the private sector. Most PPP agreements are long term and, as such, there is an inherent political risk where there may be a number of new governments within the lifetime of the agreement.

Due to political infighting, however, Kuwait implementation rate for mega projects has lagged, with many projects shelved or long delayed. At the same time, unlike other countries in the reign, Kuwait has not opened its economy to attract foreign investment - or even provided opportunities for local investors - nor diversified significantly into non-oil industries.

Kuwait’s high dependence on volatile oil exports causes wide fluctuations in economic performance. Partly because of its vast oil wealth, Kuwait has been slower than its regional
peers in developing its non-oil sector through encouraging private sector activity and attracting foreign investment. This has resulted in an oversized public sector relative to the private sector. Strategic economic development and diversification has been hindered by the contentious relationship between the government and the parliament.

**Readiness of the sector/nature of the service**

At times, certain activities are not properly “ring-fenced” in terms of organization, staffing, budgeting, setting, and revenue collection. For instance, a water and sanitation function within a city may be part of the city’s development authority and not run as a cost center. Decisions on planning and investment are taken arbitrarily and tariff setting might be ad hoc and include politically motivated decisions. In such an instance, it may not be possible to structure a concession up front, as the commercial viability of the concession could not be ensured, making it difficult or impossible to determine the true cost of service provision, of investment requirements, and of certainty of revenues.

**Risks in the stage of entering into contract with the private partner.**

**Local and national government policy**

The State of Kuwait Law establishes a legislative framework, built upon the principles of transparency and competitiveness, to promote and facilitate PPPs in public infrastructure and land-based development Projects. PPPs can be undertaken by any Public Entity (Government Ministry or Department, or entity with an independent or supplementary budget) that enters into a Contract with an Investor (a private-sector company established under Kuwaiti laws) to implement, through the execution by an investor on land owned by the State, for a certain period of time. The focal point agency for the implementation of the provisions of the PPP Law is the Partnerships Technical Bureau (PTB), Ministry of Finance, which requires a salient features:

- All companies listed on the Kuwait Stock Exchange are considered Pre-Qualified to bid for PPP Projects. Unlisted local and foreign entities will need to apply for Pre-Qualification as and when Projects are tendered, and must be approved by the Higher Committee.

- No public body may enter into a PPP Contract without first obtaining the approval of the Higher Committee for PPPs. PTB provides technical support to the Higher Committee in its decision-making.

- A Project exceeding KD 60 million must be carried out by a PPP Project company that will be a special-purpose vehicle formed as a Kuwaiti Joint Stock Company, in which up to 40 percent shares would be offered to an Investor. The majority of the remainder of the shares will be offered to Kuwaiti citizens. *”

Risks in the stage of monitoring, supervision and/or evaluation by the public sector of the mutually agreed deliverables and ensuring only justified use and safety of public assets including environmental aspects:

**Technical and organizational risks**

PPP projects tend to be long-term, typically ranging from 15 to 30 years or more. The length of the contract will typically cover the entire economic life of the asset. This can be
more complex than most government procurement projects. The government and potential private sector providers need to address several issues, such as crafting and understanding output/outcome specification, preparing whole lifecycle costing, structuring a viable and realistic payment mechanism, ensuring fair termination rights.

“With an ageing infrastructure across sectors of the government in Kuwait and the urgent need for modernizing and upgrading programs, adds difficulty to the ability of the public sector to monitor and evaluate private sector level for the achievability of requirements and program, suitability of performance and technology, and the measurement of service quality.” *

The organizational structure and the growth of bureaucracy has its impact on the political, social and economic situation in the GCC countries, including Kuwait. Clear decision-maker and decision-making process, which will ensure that critical decisions, on whether to proceed with PPP procurement, has to go through different stages in the system before any decision to be made .

**Risks of environmental Impacts in Seawater Desalination PPP projects**

Desalination remains in GCC countries the most feasible alternative to augment or meet future water supply requirements. It is considered a strategic option for satisfying current and future domestic water supply requirements, in comparison to the development of other water resources. Despite the many benefits, the technology has to offer, concerns rise over potential negative impacts on the environment. The current options for brine management are rather limited and have not achieved a practical solution to this environmental challenge.

“Environmental impact assessment (EAI) of desalination process is very important. At present, a standard EIA procedure for evaluating and minimizing the effects of desalination projects is not available. This should include basic information on all relevant impacts of desalination activity, a modular framework for conducting monitoring activities in order to investigate the environmental impacts of each project, the establishment of criteria for evaluating and assessing the monitoring data, and a decision-making tool for balancing the benefits and impacts of desalination and of other water supply options against each other. Reject brine management represents a major environmental and economic challenge for most desalination plants.”*

**Risks in the stage of transferring project or assets back to public sector:**

A key benefit of PPPs is the transfer of life cycle cost risk to the party most competent to manage it. This means the private sector pricing, for which they are at risk, is not just for the delivery of an asset, but for the cost of running and maintaining that asset and providing related services during the life of the PPP contract. And to ensure that the public sector gets best value, it transfers that life cycle cost risk to the private sector, who then are empowered to manage and maintain those assets to ensure services are delivered for the price for which they are at risk.

If life cycle risk were not transferred to the private, the public sector would retain the risk that these benefits would be delivered so a key objective of PPPs is to ensure this risk has been effectively transferred. Violation of the private sector to the standard technical specifications in the process of creating a project leading to a lack of fitness to run when the PPP project is transferred to the public sector at the end of the period .The possibility that
the technology inputs for the Project may fail to meet the required output specifications, or technological improvements may render these technology inputs out-of-date.

* Environmental Impacts of Seawater Desalination: Arabian Gulf Case Study 2012, a study by Mohamed A. Dawoud and Mohamed M. Al Mulla page 35

Risks in the arrangements of rewards or penalties:

A PPP can be structured in such a manner that the contract includes a performance-based payment mechanism, whereby the public sector only pays when services are delivered by the private sector. Moreover, the recurrent payment may depend on whether the services provided meet the specified performance standards as well. It is not just expected that a new water distribution PPP project will provide customers with adequate quantity of water, but also that the potable water is above specified quality standards.

Weak management of the PPP arrangement could lead to a various numbers of distributions in the payments and penalties process. Managing a PPP contract is a comprehensive service contract that covers all of the management and operational components of the public utility or service provider. The private contractor is paid a predetermined rate for labor and other anticipated operating costs and, often, to provide an incentive for performance improvement, the contractor is paid an additional amount for achieving pre-specified targets.

In addition, the performance system must include penalty points that are awarded for each minor breach of the performance standards and which may accumulate over time so that if there are persistent minor breaches the public sector can escalate its response to warning letters, payment deductions, or even termination.

• The nature of the supervision of the Audit Bureau of partnership contracts

The partnership contracts between the public sector and the private sector, like other contracts subject to the control of public authorities in the state, according to its value, administrative value before its conclusion be in public tenders or practices, solicitation or direct orders requests, if valued at more than 5,000 KD must be submitted to the Central Tenders Committee, if valued at 75,000 KD must be submitted to the fatwa and legislation Department, if valued at more than 100,000 KD must obtain the approval of the Office of the prior accounting before hiring, and so the case for decades of partnership, where the state party and the consequent commitment financially it.

Based on the above and based on the law of the establishment of the Court of Accounts No. 30 of 1964 and article 31 of Law No. 116 of 2014 on the partnership between the public and private sectors, which stipulates that "all subject to partnership contracts to be concluded in accordance with the provisions of this Act, including consultancy contracts

Chapter VI: The role/responsibilities of the SAIs with respect to audit of PPP arrangements:
oversight prior and subsequent to the Audit Bureau, according to the rules of censorship stipulated in law No. 30 of 1964.

- Below is a breakdown of the types of supervision of the Audit Bureau of partnership contracts:

**First: the supervision of the Office prior accounting**

Article No. (14) of the establishment of the Court of Audit Act stipulates that "the provisions of the preceding Article shall apply to each link, agreement or contract project is down its conclusion rights or financial obligations of the State or other public moral persons if it reaches the value of the link or the agreement or contract arrangement One hundred thousand dinars and more."

Accordingly, the Audit Bureau of prior accounting are as follows:

1. Verification of financial funding for the project and financial obligation on the state to exceed one hundred thousand Kuwaiti dinars.
2. Make sure to obtain all required approvals from regulatory authorities in the state.
3. Study the contract of all the technical, administrative, legal and financial aspects and making sure not to conflict with the prevailing laws and regulations.
4. Ensure that the process of selecting the winner of the investor was based on a sound and clear basis and that the selection process has based on a clear assessment and equal for all.
5. Check the company's ability to implement the project in all its aspects and make sure the text of the draft contract penalty clauses and fines in the event of breach of one of its clauses or delay in implementation.
6. Study excluded offers and make sure of the reasons for exclusion.
7. Review of the technical report and compare it with the documents provided.

**Second: The Audit Bureau subsequent accounting:**

Court of Audit shall exercise subsequent supervision as follows:

1. Verification of the safety procedures put the project in order to get the best and the most suitable prices.
2. Make sure the validity of the legal proceedings in terms of obtaining regulatory approval in the state.
3. Ensure there is no explicit provision in the contract reveals the commission presented or will be presented pursuant to the provisions of Law No. 25 of 1996 on the disclosure of commissions that offer the contracts entered into by the state.
4. Must to have the contract in Arabic, according to the decision of Council of Ministers No. 140 issued Minutes No. 88/49 dated 20/11/1998. The contract included the requirement to resort to the Kuwaiti courts in the event of a dispute between the parties based on the decision of the Council of Ministers No. 434 of session No. 9/20 dated 20/05/1990.
5. Ensure the investor to begin execution of the contract as mentioned in the contract date.

6. Access to all private and public contract and the correspondence between the terms of the administrative authorities vested and investor.

7. Study the reasons for the delay in the execution of the contract and whether the reason is due to the investor or the management.

8. Ensure Change Orders, which has the contract and study the reasons for the increase or decrease on the agenda of the contract and whether obtained the necessary approvals from regulatory bodies authorized to do so.

9. Ensure the implementation of the investor for all the terms of the contract on time and specifications mentioned therein.

Third: control performance evaluation:

A decision was made President of the Court No. 43 of 1999 with the establishment and control unit on the level of performance management. The evaluative control of the unity of control over the performance of the Audit Bureau of the latest financial control methods they are looking for the extent to which the state budget targets and thus the achievement of economic and social objectives of the society, and aims to detect the efficiency of the administrative units and make the necessary proposals to improve the quality of their performance in order to evaluate activity the government itself.

This type of control has become the standard by which measured Accordingly the government apparatus efficiency in spending and the collection of public money and the efficiency of the control device performance in monitoring how the government spends by what imposed on them from taxes, in order to audit the successful and effective investment projects and access to performance accurate assessment of completion must be that the following items are available prior to the audit process:

1. The existence of a plan with clear goals for the project from which to Measure the cost and the work that has been accomplished.

2. No precise organizational structure of the project.

3. The existence of a sound accounting system and the systems are able to provide accurate information and develop the assessment system within the investment project information in order to good decision-making at the project level on the one hand and contribute to the accurate assessment of disease on the other.

The role of the Audit Bureau in monitoring the receipt of the project at the end of his term:

1. The role of the Court is concentrated oversight when the project is received by the state after the expiry of its term.

2. Health and safety for the formation and maintenance of the project procedures.

3. Verify that the selection of the winner investor standards coincide with the global conditions applied in this area and that the steps followed in this regard was transparent and absolute justice.
4. Verify the accuracy and efficiency of rehabilitation conditions where it is necessary to ascertain the eligibility of the investor for the construction of mega-projects.

5. Review all correspondence and approvals that are made between the government agencies entrusted on the one hand and management and the competent administrative authority and the investor on the other.

6. Follow-up of the project at all levels and submit periodic reports to ensure that the implementation of the project is to plan for it.

The state audit bureau must review and examine the construction contracts during its implementation to ensure that the application of those responsible for the implementation of construction projects for the texts of the legal and financial help and technical conditions contained in the construction contract, and in general, check the following:

- Compliance with legal, technical and financial conditions contained in the contract.
- Verify the accuracy of financial extracts from the work done and compliance with the enclosed documents and the adequacy of these documents.
- Commitment to the program prepared for the implementation phases during the contract period.

This censorship in checking and reviewing internal control systems and financial documents and accounting data installed the books, records, and financial statements. In order to validate the implementation of projects and according to plan, and the extent of the commitment allocated in the budget appropriations. In addition, whether implementation has achieved the objectives of the results that require the allocation of these funds.

According to the third paragraph of Article 9 of Law No. (30) of 1964, the establishment of the state audit bureau, as amended, the audit bureau must verify that the disbursements discount on prescribed credits for construction projects has been spent in the aspects which have been allocated these funds, and it did not initiate any action not originally adopt the budget before it is decided an additional appropriation.

The audit bureau also verifies that spending on construction projects have been in accordance with the terms of contracts with contractors, and exchange orders have been issued proper and competent authority and they are accompanied by documents and proper clearances. In addition, that the Special disbursement accounting entries have been radical and systematic manner in accordance with the financial and accounting regulations and the general rules of the budget. Moreover, making sure of the procedures between the credits construction projects as defined by circulating the Ministry of Finance No. Checker (2) for the year 1992 the terms of the amendment of budget allocations in government agencies, including:

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**Chapter VII: The types of audit of PPP projects thus far conducted by SAIs:**

...
The transport of the project has been contracted.

Transportation not affect the implementation of the transferred him to the project.

The result in transport raise the total cost of the project transferred from it.

Write to the Ministry of Planning to give its opinion technically, and the transfer is made after the approval of the Ministry of Finance.

The audit bureau must also audit and examine the following:

- Final account prepared by the agency responsible for implementation upon receipt of the project from the contractor review.
- Verify that disbursements may be paid for work already performed, they deducted from financial dependence due to the project, and it did not go beyond.
- Verify the adequacy of the work that has been done in terms of the prescribed period, meaning that construction work had been carried out during this period, and it did not happen exceeded them.
- Ensure that the work has been done accordance with the technical specifications and assays for materials and wages and prices contained in the terms of the contract, and it did not happen deviation of what is required

The audit bureau under the terms of reference given to the following authorities:

- Study and review of the documents contained him by the Ministry of Public Works. In addition, to discuss with its representatives sees explanations required by the process of obtaining the prior approval. If the value reached a quorum by the minutes of a meeting between the parties, and the Office of the right:
  - Absolute approval of the contract.
  - Conditional approval of the contract.
  - The disapproval of the contract.

Chapter VIII: Collect opinion of a representative sample of projects management from research team member countries on the hitherto audits of the projects:

- The disapproval of the contract.

The Government of the State of Kuwait has been involved in many partnership projects with the private sector for many years. However, the legislation of these partnerships were not enacted before the year 2008, when the law No. 7–2008 was issued and specialized in arranging transformation and construction process and other similar systems “B.O.T” before its adjustment and the enacting of the current law No. 116-2014 relating the partnership between the public and the private sectors. In the following chapter, we will review some of the projects under the supervision of the Kuwait Authority.
for Partnerships Projects (KAPP) and we will submit a case study about one of the PPP projects in Kuwait.

- **About the Kuwait Authority For Partnerships Projects (KAPP)**

  The Partnerships Technical Bureau (PTB) was established in 2008, under Article 12 of Law No. 7/2008 and serves as the main body responsible for PPP projects implementation. PTB aims to utilize private sector skills and expertise to maximize value for money and service quality. PTB is currently in the process of initiating several high-impact projects in the power, water/wastewater, education, health, transportation, communications, real estate, and solid waste management sectors.

**PTB’s Objectives**

- Increasing Kuwait’s Gross Domestic Product and diversifying its sources
- Encouraging private sector participation in development projects
- Improving public sector service quality
- Promoting human development and creating job opportunities for Kuwaiti nationals
- Promoting scientific research and technological development

**PTB’s Mandate**

In collaboration and coordination with the public authorities, the PTB shall be responsible for the following:

- Conducting surveys and initial studies to identify potential development projects.
- Developing PPP project concepts, conducting pre-feasibility studies, and selecting qualified PPP transaction advisors.
- Studying projects and Unsolicited Proposals referred by the Higher Committee, evaluating economic and technical feasibility studies and providing recommendations on tendering projects Managing feasibility studies development and procurement process for PPP projects.
- Preparing model contracts which set required terms and provisions for PPP projects.
- Developing methods for project follow-up and performance evaluation.
- Following up on project implementation and providing quality technical assistance to Public Entities throughout the project cycle.
- Arranging final award to successful bidders and setting up joint stock companies.
- Preparing and submitting an annual report on development projects to the High Committee for approval, to then be referred to the Cabinet by the Minister of Finance.

**Higher Committee’s Role**

The Higher Committee is in charge of the following:

- Providing final approval to Public Entities to enter into PPP contracts.
- Approving project concepts and Unsolicited Proposals before they are advertised and tendered.
• Developing general policies for projects and Unsolicited Proposals of strategic importance to the national economy.
• Selecting the relevant public entities that will partake in the tendering process and the signing of the PPP contract.
• Determining and supervising the public entities that monitor PPP projects implementation and operation.

Higher Committee Members
The members of the Committee are:
• Minister of Finance (Chairman)
• Minister of Municipality
• Minister of Public Works
• Minister of Commerce and Industry
• PTB President
• Undersecretary of Ministry of Electricity and Water
• Director General of the Environment Public Authority
• Two experienced specialist

Pre - Tendering Projects:

Kuwait Metropolitan Rapid Transit System (KMRT)

Kuwait’s Master Plan for urban development and the “Vision for the State of Kuwait – Kuwait 2035” recognize the necessity of urban transportation improvement as a key driver of economic progress. In line with Kuwait’s national strategy for implementation of modern urban transportation systems, the Ministry of Communication is seeking a private partner to implement the Kuwait Metropolitan Rapid Transit System (KMRT) project. The project will help define the future direction of public transport in Kuwait, paving the way for future public transportation projects.
The KMRT system will consist of an integrated network-unified fleet and limited passenger interchange. The system will comprise 69 stations with a total length of 160km. The trains will be driverless with an operation speed of 90kph, and a maximum speed of 100kph. The project will unfold in 5 phases, with phase 1 operations expected to commence in 2020.

**Kuwait National Rail Road (KNRR)**

One of Kuwait’s key infrastructure development initiatives is the implementation of an advanced public transportation system. As such, the Ministry of Communication (MoC) wishes to develop a railway system that will link Kuwait city to Kuwait airport, seaports, and other GCC countries. The project will enhance Kuwait’s regional integration, boost trade volume, and create new job opportunities.

The Kuwait National Rail Road System will be an integrated rail network with 511 kilometers double track total length. The Rail Road system will serve freight and passengers and will have a 120 km/hr regional lines speed and a 200 km/hr high speed. The project will be implemented as a build, operate, and transfer (BOT) agreement. The project is currently in the feasibility study phase.

**Commercial, Educational, Cultural and Entertainment Center in Abdulla Alahmad Street**

The State of Kuwait, through the Partnership Technical Bureau (“PTB”) in collaboration with Kuwait Municipality (KM) is preparing to develop a Cultural, Entertainment, and Educational Center on Abdullah Al Ahmed Street. The project will provide state of the art cultural, entertainment and educational facilities available for residents and visitors to Kuwait. In addition, the Project will boost growth of tourism and the economy as a whole.

The Project will be developed under a concession scheme on two plots on Abdullah Al-Ahmad Street separated by Khaled Ibn Al Waleed St. The concession contract will be for 30 years after which all assets will be transferred to the Government. The combined area of the plots is 52,326 m2. The Center will include:

- Convention center and auditorium
- Exhibition halls
- Training center
- Multi-cinema complex
- Art Museum
• Commercial services (retail shops & restaurants/cafés)

Parties interested in bidding for the project will enter into a competitive tendering process. Proposals submitted will be evaluated mainly on the technical aspects including architectural design, variety & characteristics of the components, and integrity of the financial model. The financial proposal will only comprise the land lease value to be paid annually to the Government. The request for Expressions of Interest is expected to be released in the first quarter of 2012.

Rest Houses And Doha Chalet’s Service Centers

The State of Kuwait, through the Partnership Technical Bureau (PTB) in collaboration with Kuwait Municipality (KM) is planning to develop 17 rest houses and 2 chalet service centers as a PPP project. The project intends to provide quality services for highway and causeway users in remote areas where services are unavailable.

The 17 rest houses will be located on 5 main highways (Kabd, Wafra, Abdali, Sabiyah, and Al Salmi) and the 2 chalet centers will be located in Al Doha. The rest houses and chalet service centers will be divided into 4 packages. Each package will contain 4 to 5 different locations, and each location has a site area of 3,000 m² dedicated to it. This will include commercial spaces that will consist of minimarkets, restaurants, cafeterias, mechanical workshops, etc., as well as public spaces with prayer areas, rest areas, parking areas, and landscaping.

Interested parties will enter into an auction for rent to be paid to the State over the duration of the contract. The project will be procured as a build, operate, and transfer (BOT) agreement. The contract duration will be 22 years- 2 years for construction and 20 years for operation. After the 22-year period elapses, all assets will be transferred back to the State. The Higher Committee has approved the project feasibility study and a request for Expressions of Interest has been released. The RFQ documents for the project are currently being developed.

South Al-Jahra Labor City

The South Al-Jahra Labor City project involves the construction, operation and transfer of a 1,015,000 m² Labor City which will provide adequate and affordable housing for 20,000 male, bachelor, expatriate workers. The project will incorporate all aspects of security, health, entertainment while maintaining consistency with the cultures and traditions of this considerable category in Kuwaiti society.

This project demonstrates Kuwait’s commitment to national welfare. The Government of Kuwait consistently strives to provide welfare support to all categories of Kuwaiti society. The project is now in the RFQ development phase of procurement

New Physical Medicine and Rehabilitation Hospital

The Government of Kuwait has embarked on plans for major developments in the national healthcare sector, a key goal being hospital capacity expansion. These plans include the construction of new hospitals that will serve as centers of excellence for physical medicine and rehabilitation services.

In line with Kuwait’s national healthcare strategy, The Ministry of Health in Kuwait is seeking to procure the New 500 bed Physical Medicine and Rehabilitation Hospital and Related Facilities project as a PPP. The private partner will design, build, finance, maintain
and operate the 500 bed New Facility that will be located on the site of the existing Physical Medicine and Rehabilitation Hospital in Al Andalus, Kuwait.

**Tendering Projects:**

**Services and Entertainment Center - Egaila**

The project involves the development of a top-notch services and entertainment center in the Al-Egaila Area.

The primary objective of the project is to meet the existing demand for commercial and entertainment outlets in the area surrounding the project site, to minimize residents' need to seek required services in nearby districts/governorates.

The term of the contract with the Kuwait Municipality is expected to be 27 years in addition to 3 years for the design, construction and finance of all the infrastructure assets.

**AlKhairan IWPP (Phase I)**

An Independent Water and Power Producer (IWPP) Project is being planned to generate power with a minimum capacity of 2500MW through a Conventional Thermal Steam Power Plant (using Low Sulfur Fuel Oil -LSFO, Gas Oil, Crude Oil and /or Natural Gas). The Project will be located at AlKhairan, south of the existing Az-Zour South Power & Water Production Station.

In addition to its power generation capacity, the project will include a Sea Water Desalination Plant with a total minimum capacity of 125 MIGPD utilizing MSF, MED and/ or RO Technology.

The IWPP Project will be set up as a Special Purpose Vehicle (SPV) which will design, build, finance, operate and maintain the power generation & water production facility for a fixed duration of time, as stipulated in Law 39/2010, Law 7/2008, and their respective bylaws. The SPV will sign an Energy Conversion and Water and Power Purchase Agreement (ECWPA) with the Ministry of Electricity and Water (MEW).

**Az-Zour North IWPP (Phase 2)**

Az-Zour North site is a complex of power generation and water production which is expected to be developed in five phases.

The Partnerships Technical Bureau in collaboration with Ministry of Electricity and Water is in the process of executing the second phase of Az-Zour North Complex Independent Water and Power Producer (“IWPP”) project (the “Project”) involves the development, design, engineering, construction, operation, maintenance and transfer of a power and desalination plant with a capacity of at least 1,500 MW and 102 MIGD. The Project also includes the sale and purchase of associated power and water by the Ministry of Electricity and Water pursuant to an Energy Conversion and Water Purchase Agreement (ECWPA) for a term of no more than 40 years in accordance with laws 39/2010, 28/2012 and 7/2008.

Other significant agreements include a Land Lease Agreement for the use of the site and a Shareholders Agreement for the establishment and management of the Project Company. The project will be located at the Az-Zour North Site on the Arabian Gulf coast approximately 100 KM south of Kuwait City.
It is expected that the project will apply Combined Cycle Gas Turbine technology and an open source desalination technology as per the tendering documents requirements. The net contracted capacity shall be at least 1,500 MW and the net contracted water capacity shall be at least between 102.

The distillate water will be re-carbonated prior to delivery to the AZ-ZOUR WDC reservoir through 4 new pipelines (1600) constructed by MEW. The project developer shall be responsible to construct a 400 KV substation to evacuate the generated power. The plant will be fired with fuel (natural gas) as main fuel and with fuel oil (gas oil) as back-up fuel.

The fuel natural gas will be delivered by the MEW through one new pipeline (40”) constructed by KPC/KOC. As for the gas oil it will be delivered by MEW through one new pipeline (16”) branched from new pipeline (24”) constructed by KPC/KOC.

Al Abdaliyah Integrated Solar Combined Cycle (ISCC)

The Abdaliya Integrated Solar Combined Cycle Project was submitted to PTB Higher Committee, as part of an unsolicited proposal. The project will develop the first solar thermal power plant in Kuwait. The total capacity of the power plant will be 280 MW, with a solar contribution of 60 MW. The plant’s utilization of solar energy will contribute to fuel saving.

An additional environmental benefit is that annual CO2 emissions will be 48,000 tons less than that emitted in a conventional plant of comparable capacity. The plant will provide services more efficient than that of a conventional combined cycle power plant, with stable continuous power generation. The feasibility study for the project is currently in being developed.

Kuwait Schools Development Program

Education is a strategic priority to the State of Kuwait. The Kuwaiti education sector is under pressure to develop better education facilities at all levels that would allow Kuwaiti nationals access to better education, enabling them to face the increasing competition from quickly progressing societies.

Each year the Kuwaiti annual population increases by 2.9%, adding more pressure on the government to build new schools. The quality of existing schools is a concern to the Ministry of Education.

In light of these concerns, the Partnerships Technical Bureau and the Ministry of Education have embarked on a path to involve the private sector in helping the State of Kuwait meet its increasing demand for educational facilities. Thus, the Kuwait Schools Development Program has been launched against this backdrop to develop high quality schools.
As a first phase of Kuwait’s Schools Development Program, the Ministry of Education is pursuing the development of 9 schools (5 kindergartens, 3 elementary, and 1 middle school), a residential building for school faculty, and an Olympic size swimming pool (the “Project”) across Kuwait.

The Project is envisaged to be designed, built, and maintained by capable private sector Investors with international and regional experience in developing and managing similar projects. The Ministry of Education will be responsible for managing the schools’ administration and educational curricula and will appoint all teaching and administrative staff, while the Investor will be responsible for building, financing, and maintaining the facilities. The Investor will also be responsible for providing facility management services over an agreed upon contract duration for the developed facilities.

**Umm AlHayman WWTP**

Due to strong demand for wastewater treatment capacity in Kuwait, the Ministry of Public Works (MPW) has decided to expand and rehabilitate the sewerage system in the Kuwait Southern Area. An integral part of this overall improvement program is the Umm Al Hayman (UAH) Waste Water Project. The objective of the project is to mitigate the negative impact of the increasing discharge of raw wastewater into the environment by establishing an upgraded and larger capacity WWTP that will treat collected wastewater and produce an effluent suitable for landscape irrigation. The project involves the design, financing, building, rehabilitation, testing, commissioning, operation and maintenance of several components. The project involves:

- Construction of a new Wastewater Treatment Plant (WWTP) with an initial treatment capacity of 500,000 m³/d, which can be expanded to 700,000 m³/d by 2020 should the MPW identify demand for it.
- Upgrading and extension of the Egaila pumping station, refurbishment of UAH City pumping station, and construction of Sabah Al Ahmed pumping station.
- Construction of emergency outfall from the new WWTP to the sea.
- Potential demolition of the existing UAH WWTP, adjacent to the plant site, which has a capacity of 27,000 m³/d and provides primary, secondary and tertiary treatment for reuse of the produced TSE.
- Construction of five new sewer transmission lines.
- Construction of TSE transfer and distribution systems to allow for re-use of the TSE.

**Municipal Solid Waste Treatment Facility – Kabd Location**

The Project will utilize the latest technology to treat municipal solid waste in Kuwait. The Project aims to protect the environment and land resources, and to generate alternative power sources to be purchased by the Ministry of Electricity and Water.

The Project site is located south of the ground broadcasting station in the Kabd area, 35 km away from Kuwait City. The site dimensions are 1000 m x 500 m, with a total area of 500,000 m². The site will provide a number of services including treatment using incinerators for generating electricity, and landfilling the ash from the remains of the incineration. The total volume of the remains after burning should not exceed 5% of the
total volume of waste. The plant is expected to receive 50% of total municipal solid waste produced in Kuwait.

**Technical advisor procurement phase:**

*Kuwait Failaka Island Development*

The Government of Kuwait is planning the implementation of the Kuwait Failaka Island Project (KFIP) as a PPP. The project will transform Failaka Island into premier, state of the art leisure and tourist destination. Preservation and promotion of the island’s outstanding heritage and archeology are drivers of the project.

Cultural facilities will be integrated with regular tourist and leisure facilities such as hotels and leisure parks. The will comprise the development of hotels suited for week-long stays as well as a town center for commerce, food & beverage, retail and other activities.

**Case Study of the Northern Alzoor station for generating electricity and water desalination:**

The Northern Alzoor station project is considered as one of the most important projects for its strategic importance. This project imposes the law No. 39-2010 (related the foundation of Kuwaiti shareholder companies which execute and build the stations of electrical energy and water desalination in Kuwait) which can found a shareholder public company.

The project is subjected to the law No 39-2010 concerning the foundation of shareholder Kuwaiti companies to execute and build the stations of electric power and water desalination in Kuwait.

Its first article states the following: the Ministers council authorizes any governmental department to found a shareholder Kuwaiti company or more lies in Kuwait, its aim to execute, build, operate, manage and maintain the electrical power and water desalination in Kuwait, therefore the technical board for studying the developmental project has set up a shareholder Kuwaiti company in accordance with the Fatwa and legislation department, in addition to the ministry of electricity and water to prepare a by-law.

The announcement for the project offering by companies in the official newspaper and the foreign company’s invitation has been made so, all the documents have been sent to the council of Ministers to agree on the participation of the foreign companies and turndown the undesirable companies. After the Ministers council had accredited these companies, they were invited with other Kuwaiti stock market companies to show their offers.

The group of participants led by GDF SUEZ has won and became the responsible company for executing, developing, designing, planning, ownership, operating, maintaining and transporting the station of governing electric power and water desalination with a capacity of 15,000 MGW as a minimum limit and produce not less than 102 and not more than 107 Million emperor gallons of desalinated water by using Fizzy generators according to the system of the partnership between the private and the public sectors and the consultancy department which won the follow up and revision works should make sure that
the first Northern Alzoor company (a Kuwaiti’ shareholder company) must have all the
document, and guarantees that prove all the special measures of the complete commercial
operating of the project (project completion operation Date) and this should be done
according the agreed conditions of the energy conversion agreement and water purchase
which was signed by the Ministry of Electricity and water and the first Northern Alzoor
company.

The achievement of this project is considered a part from the strategy of Kuwait in
increasing the energy production capacity as a result, the Northern Alzoor station started
working as a project drawn from the partnership law between the public sector and the
private one.

**The most important achievements of the project are:**

- The contractor has received the site on 12\textsuperscript{th} December 2012 when the contract was
  signed, since that time both the investor and the contractor have been working day and
  night to fulfill the agreed contracting times.

- The partnership of the Northern Alzoor company the first is divided between consortium
  from the private sector which owns 4% of the company and this company (Consortium)
  includes “Enjy” company (Which was named by GDF SUEZ) and “So mytomo
  Corporation” company and ABDULLAH HAMAD ALSAQR and Brothers company. The rest
  portion which estimated by 60% is owned by the Kuwaiti government through. The
  public authority for the Kuwaiti investment a which owns 5% and the Public
  establishment for social insurances which also owns 5% and the authority of the
  partnership between the public and the private sectors which owns 50% and the
  government will soon offer apportion of 50% as a public subscription for the Kuwaiti
  citizens whose names are reordered in the recorded public Authority for Civil
  Information in accordance with the date of subscription date to have 10% of its portion
  as a rest.

- The complete commercial operating of the station started on 26\textsuperscript{th} Nov. 2016

- The station includes five general electric turbines (GTG 9FG-3) and each one generates
  225-8 MW and two turbines from general electric (STGD1) each one generates 251 Mw.

- The station is operated by using a combined cycle depending on the natural gas as a
  basic fuel and the oil of gas as an alternative fuel.

- The productive five capacity of this project will take part with more 10% out of the total
  of the electric generation capacity in Kuwait and it will take part by 20% approximately
  out of the total water desalination capacity and total of the station production will be
  offered to the citizens and the expatriates in Kuwait through the ministry of water and
  electricity according to a permanent agreement of 40 years.

- The number of working hours since the beginning of work is more than 26,000,000
  Million hours.

- There is no accident against the environment has been recorded yet.

- The early electrical generation was after 18.5 months from the beginning of the station
  construction.

- The project has been completed according to the planned budget and the time limit.
The time limit of the first Northern Alzoor station as follows:

i. In March 201: the tender of the station construction was offered.

ii. In March 2012: Choosing the consortium which submit the best offer.


iv. In 12th of Dec. 2013: The completion of the first tender for establishing a special station successfully and the celebration of signing the agreement with the ministers of water and electricity and the start of the construction process.

v. On 10th Jan., 2014: The completion of the financial transaction of the first Northern Alzoor company.

vi. On 13th March 2015: The agreement with the ministry of electricity and water and Kuwait oil company on executing:
   - Constructions for conveying electricity.
   - A main linking network for fuel (Kuwait Oil Company)
   - A reserving link network for fuel (Kuwait Oil Company)

vii. On the 3rd of May 2015: Generating the first electric MW and transferring it through the national electric network.

viii. On the 28th of Jan 2015: The system improving energy consumption: handing the first 992 turbine with a capacity of 214.3 MW.

ix. On the 11th of Aug. 2015: The system of improving the energy consumption delivering two gas turbines with a capacity of 440.5 MW before two days of the due time.

x. On 18th Sep. 2015: the system of improving consumption delivering three gas turbines with a capacity of 664.2 MW 10 days before the due time.

xi. On 26th of Nov.: The completion of construction works and start the commercial works completely.
• The last scene of the project after its achievement.

• A part from the continues works in the project.
• The first turbines in Alzoor station after its stabilizing on pedestals.

• **Problems that correspond to the audit bureau during the examination and review of contracts for PPP projects:**

  Some problems cause a hindrance in the way of implementation of these projects. In accordance with the programs of the time their respective financial credits, which have become the abnormal phenomena, must be on all stakeholders to cooperate. In order to reduce them, as they have a direct negative impact on the implementation of projects in a timely manner specific. plus they pose additional burdens on the budget as a result of its deployment significantly represented in Change orders, re-measurement, reserve funds, and compensation paid to contractors as a result of raising the issues on the ministry's mistake.

• **Effective control methods and carried out by the Audit Bureau on these stages and are as follows:**

  • Examine the procedures and systems in place approaching concerned to approve the implementation of the project, and the position that the development plan of the state, and the vulnerabilities and deficiencies in those proceedings.

  • Review and examine of changes to the scope of the contract. whether by omission or added where these changes will be a gateway ground for claims, and the evasion of the contractual price to replace them new prices higher than the prices listed in the contract. Also opens the door to demand the extension of the contract resulting in the exemption from fines for delays.

  • Examining requests, the contractor because of negligence by the owner, or an emergency is not the contractor's hand in it, such as force majeure.

  • Discuss the problems facing the implementation of the projects, and the impact on the state plan, and public money with an analysis of some of these problems and determine the causes.
• Examination of the size of a cross from the ministry on others issues, and others to the ministry, and the result of all of them, identifying the shortcomings in the procedures and regulations of the ministry, and the impact on consultants and contractors’ claims.

• Examine the reasons for the large increase in the value of which produces some of the projects for their original cost, and to clarify the reasons for it.

• Examine the reasons for the delay in the implementation of some projects for the date set for completion, with an analysis of the reasons for this.

• Examination and review of the existing internal control systems to those entities that in the process of implementation or supervision.

• Examination of documents, records and data that show due to the disbursement of funds analysis. In order to verify and validate the implementation of projects. And according to plan, according to the terms of assets and technical specifications for each project and the authorities commitment to implement in light of the allocated funds, the health of the disbursement of these funds in accordance the laws and regulations so to reach the goals that allocated for which these funds.

• Examine the reasons for the lack of or inadequate documentation and causing it they been held accountable for this office, whether a consultant or employee department.

**Chapter XI : The challenges and difficulties, which face the members of the research team while revising the contracts of public and private partnerships:**

According to the article context, no.31 of the law no.116 for the year 2014 related to the public and private partnerships, which stated the following:

“All the partnerships contracts which are made according to the terms of the above law as well as the consultation contracts based on the previous and past supervision of the State Audit Bureau In accordance with what is stipulated in the law no.20 in 1964”

Since the Kuwaiti law of organizing the partnership contracts has authorized the task of checking the partnership, contracts to the SAIs auditors who may face difficulties during checking such contracts.

• The most important difficulties, which may face auditors, are as follow:

1. The private sector, which is represented by the investor, may lack the sufficient experience of the tasks authorized by the SAIs auditors. So, they may not be provided with the details by which they can practice the checking process. This obliges the public sector to explain the nature if the checking process to the private sector auditors as well as the responsibilities and the morals of the auditing job like integrity, objectivity, independence and the confidentiality of the information they get while practicing their jobs.
2. The underestimation of the government agencies to observatory role made by the State Audit Bureau.

3. Some governmental agencies see that the State Audit Bureau is the directorate of catching mistakes and not giving directions.

4. The auditor may face some deceiving behaviors made by some civil servants life dishonesty and lying on the auditors and their decline to answer their questions frankly in addition to their illegal behaviors.

5. Some governmental directorates complain the weakness of some employees who belong to the accountancy department as well as the weakness of the interior supervision.

6. Another problem is that the multiplicity of the governmental agencies for the projects and the lack of coordination among them and the contradiction of their measures which lead to the difficulty of applying the auditing rules and the authorized responsibilities.

7. The variety of departments inside the governmental directorates, which can reply the board, question and following their notifications so, this can clog up the work of board supervision.

8. In some governmental directorates, the departments of the board deal directly with the financial departments and ignoring dealing with the engineering technical departments, which cause a delay in replying the auditors’ investigation.

9. The length of the documentary course inside the governmental bodies in replying the questions made by the State Audit Bureau.

10. The pre-occupation of the governmental departments with their designing and supervisory tasks and this of course leads to a delay in replying the board investigations.

11. Sometimes, the governmental departments do not follow the State Audit Bureaus’ requirements in the field of the previous supervision or the late supervision specially while preparing the contracts projects.

12. The authorized governmental directorate for implementing the partnership contract may fail in dictating its requirements clearly from the beginning so, this may lead to the increase of risks to the government and this may lead to an insufficient project, thus the auditor may face more responsibilities and tasks in checking if the government department has distributed the projects’ risks equally among the parties of the contract and recording the notes as well as monitoring the irregularities of the government department to the board requirements in addition to the lack of appreciating the requirements completely and clearly.

13. The projects that need the supervision of the State Audit Bureau are too many and varied whereas the number of board engineer and auditors are too few, in comparison with the number of projects, as well as the number of the experienced observatory auditors in the board, thus the auditor may face a big pressure in checking the partnership contracts as well as the other checking tasks.

14. The decline of the government departments to facilitate the tasks of the site supervision made by the board councils to avoid monitoring irregularities.
15. Some departments have a mismanagement in the design stages or executing and monitoring projects.

16. Banning the implement of the supervision role made by the same departments despite its importance. Especially in the partnership projects between the private sector and the public sector.

17. Minimizing the field of research and auditing for supervising tasks in law and accountancy specializations despite the development and the variety of the supervision of the big projects.

18. Too many kinds of pressure are faced by the board engineers and auditors as a result of the nature of their accurate sensitive work.

19. The scarcity of the field visits to the sites of government projects by the SAIs auditors.

20. The pre-occupation of the post-supervision researches in preparing the subsequent reports was one of the causes of delaying the implement of any technical and specialized studies for any negative effects which have already been recorded by the SAIs auditors concerning the big projects.

21. The government agencies issuing several orders for change on a single project as a result of not doing a good study of the project before contracting, leading to increased regulatory burdens as the auditor must make sure not to overlap or repeated acts in orders to preserve public money.

Generally, the whole challenges and difficulties which face the auditor have negative effects on the work done by this important supervising body in the state as well as its required role concerning watching all the state funds and preparing an objective annual report for all governmental departments and in order to avoid all these difficulties the auditor of the accountancy body should take a lot of measures in addition to the usual tasks which are considered an additional job because it takes too much time in fulfilling his other supervisory tasks for example:

1. Doing a sudden visit to the sites and make certain tests without any prior notice.

2. Improving the present style of auditing, in comparison with the last years, for example doing oral calls to the people responsible of the projects or asking for additional and different information.

3. Running interviews with the employees who take part in the fields which contain substantial mistakes in order to get their comments concerning these mistakes and if the supervisory bodies have to deal with them or not.

4. Seeking additional auditing details from other sources different from the one being checked.

5. Guiding the government departments to the best ways of preparing contracts and their future contracting documents.

6. Providing the post supervisory bodies with specialized engineers to follow the tasks of the observations required from the board bodies and to form a technical and direct support to the auditor for improving his supervisory tasks.
7. Supporting the governmental departments to apply and motivate the stipulations of the State Audit Bureau.
5. MALAYSIA

CHAPTER 1
RESEARCH BACKGROUND AND METHODOLOGY

Chapter 1 starts with a discussion on the research background and methodology regarding on implementation of Public Private Partnership (PPP) Project in Malaysia. The purpose of Section 1.1 is to provide the reader with the background necessary to facilitate the understanding the research project. In order to examine the research questions, Section 1.2 highlighted several research project objectives. This is followed with the Section 1.3 that discusses the research methodology. Finally, Section 1.4 ends up with a summary of findings and recommendations.

1.1 Background: Public Private Partnership (PPP)

PPP which was announced in the Ninth Malaysia Plan (9MP) in March 2006 aims to facilitate greater private sector participation in improving the delivery of infrastructure and public services. It sets out some key principles on procurement and implementation of public sector infrastructure projects. PPP will be implemented to increase private sector participation in economic development.

According to Guidelines on PPP (Prime Minister Department (PMD), 2009), PPP involves the transfer of responsibility to the private sector to fund and manage a package of capital investment and services, including construction, management, maintenance, repair and replacement of public sector assets such as building, infrastructure, equipment and other facilities. For PPP projects, the private sector contractual and are required to provide service-based public infrastructure in the long term. The private sector will generate its own funds to finance the whole or part of the assets that will provide services based on agreed performance. In return, the Government or in certain public projects will make payments to the private sector for those services.

Although the ownership of assets is not emphasized in the PPP, the transfer of assets to the public sector at the end of the concession period is as usual process. PPP projects that do not involve the assets usually relate to facilities or who have a minimum value at the end of the concession due to technological obsolescence. A PPP proposal will only be considered if there is a need on the part of the Government for the project taking into the overall benefit, among others, in terms of impact to the socio-economic, value for money and cost savings to the Government, delivery of the project in a shorter time and increase service levels, and increase the level of accountability, efficiency and effectiveness.

PPP is a method of public procurement in which the element of value for money is optimized through efficient allocation of risks, the long service life of the assets, private sector innovation and management expertise as well as mergers elements of the design, finance, construction and operation of related projects. Some of the key features of PPP projects are as follows:

- a) the relationship between private and public sectors is based on partnerships;
- b) public sector will determine the output specification for the duration of the concession period;
- c) private sector will determine the required input and the freedom to introduce innovations into the design and development to reduce the overall cost of a project;
d) payment for services is based on the performance and standards that have been determined;

e) encourage maintenance culture which is responsible for maintaining the assets over an agreed period of operation;

f) integrated the design, construction, financing, maintenance and the operations into the whole package;

g) transferring owned assets after the expiry of the concession period is an option for the Government;

h) sharing the risk optimally in which a risk is allocated to the party best able to manage it; and

i) Whole Life Cycle Costing (WLCC) in which PPP projects are often awarded based on the lowest total cost over the concession period compared to the lowest construction costs under normal procurement methods.

The main objective of PPP projects is Value for Money (VFM), defined as the optimum combination of whole life cost and quality appropriate to the needs of the users. VFM generally achieved through transferring of risks optimally between public and private sectors, using output specifications efficiently, providing fair competition project and performance-based payment mechanism. Generally through the PPP approach, it emphasizes on service delivery or output driven as well as the expertise and innovation of the private sector in maintaining the assets/facilities throughout the concession period. The difference of PPP with other procurement approach is shown in Table 1.

| Table 1: Differences between Conventional, PPP and Privatization Approach |
|---------------------------------------------------------------|-----------------|-----------------|
| **Conventional**                                             | **PPP**         | **Privatization** |
| Procurement was financed directly of the Government budget.   | Funding from the private financial resources without any Government guarantee. | Funding from the private financial resources without any Government guarantee. |
| Impacts directly to the public sector financial position.     | The impact on the public budget will be distributed during the concession period. | No impact on the public budget. |
| Risks will be borne entirely by the public sector.            | Risks will be distributed during the concession period. | Risks will be borne entirely by the private sector. |
| Public sector involvement in every stage of the project life span. | Private sector involvement through KPI enforcement. | The Government acts as regulatory bodies. |
| Short term contracts with the private sector.                 | Long term contracts with the private sector. | Long term contracts with the private sector. |
| Suitable for projects which have high impact on socio-economic. | Suitable for a viable commercial project. | Suitable for a high viable commercial project. |

Source: PPP Unit, PMD

1.2 Research Objectives
The main objective of the research is to examine the implementation of audit of PPP in Malaysia. This research is intended to achieve the following seven (7) specific research objectives:

1.2.1 Explain the legal/statutory frameworks in place, for governing and regulating the PPP arrangements. (Chapter 2)
1.2.2 Identify the types of PPP arrangements and their linkage with the socio-economic priorities. (Chapter 3)
1.2.3 Ascertain the general risk situations faced by SAIs for the identified PPP arrangements. (Chapter 4)
1.2.4 Describe the role/responsibilities with respect to audit of PPP arrangements. (Chapter 5)
1.2.5 Study the types of audit of PPP projects thus far conducted by SAIs. (Chapter 6)
1.2.6 Collect opinion of a representative sample of PPP projects’ management on the hitherto audits conducted by SAIs. (Chapter 7)
1.2.7 Identify the challenges/constraints faced by research team member SAIs in fulfilling their role/responsibilities with respect to audit of PPP arrangements. (Chapter 8)

1.3 Research Methodology
A survey is conducted as the quantitative approach to explore relationship of auditors’ experience and cultural dimensions on auditors’ fraud risk assessment. In this study, fraud risk assessment refers to the auditor’s perception on the likelihood of material misstatements due to fraud. The research uses a survey involving a distribution of questionnaires to auditors. The randomly chosen selected auditors were contacted by email to get the permission of their participation. The questionnaires were sent by email to the respective auditors. Three weeks after the initial mailing, a follow-up was made to remind the participants of the completion and return of the questionnaires. The research instrument is contained in a booklet. It includes a cover letter which provides a brief description of the study, a statement on the assurance of anonymity and confidentiality of responses, and a request for participation.

1.4 Summary of Findings and Recommendations
The findings from the survey explain the associations between auditors’ fraud risk assessment and cultural dimensions using the social cognitive theory. Results of this study are expected to explain similarities or differences among the auditors in the manner they apply the concept of professionalism as part of audit procedures. It is hoped that the findings would contribute towards the formulation of a clear guidelines on the application of professionalism in auditing financial statements.

CHAPTER 2
EXISTING LEGAL AND STATUTORY FRAMEWORKS FOR GOVERNING AND REGULATING THE PPP ARRANGEMENTS
Chapter 2 is divided into sections that present a need of comprehensive legislative and statutory frameworks, and existing situation which regulating the PPP arrangement.
2.1 Legislative and Statutory Frameworks

The implementation of Malaysian privatization is not governed by any specific PPP legislative and statutory frameworks. In contrast, public procurement of infrastructure and service in Malaysia is strictly governed by Treasury Instruction, Circular Letters and Federal Contract Circulars. Through these instruction and circulars, the whole process of Government’s procurement of works (infrastructure), services or assets is clearly and comprehensively outlined in all stages of its implementation. By having a complete regulatory framework, Government procurement can be implemented with the principles of public accountability, transparency, value for money, open and fair competition and fair dealing as its basis. For project development procured, its implementation is enabled through the combination of these guidelines:

2.1.1 Malaysia’s Guideline on Privatization

The Malaysia’s Guideline on Privatization released in 1985 by the Economic Planning Unit (EPU) in The PMD of Malaysia among others outlined the specific objectives of Malaysia’s privatization initiative which are to reduce the Government’s financial and administrative burden, promote competition, raise efficiency and productivity, accelerate growth, reduces Government’s involvement in the economy and to achieve the targets of the New Economic Policy (EPU, 1985).

2.1.2 Malaysia’s Privatization Master Plan

Malaysia’s Privatization Master Plan (PMP) was released in 1991 with the purpose of clarifying to the public about the Government’s privatization policy so that the public “can participate and understand the Government’s privatization approaches” (EPU, 1991). Provision for PPP as one of the privatization method for implementation was clearly stated in the PMP under the “forms of privatization” subheading. The PMP also expressed under the ‘project implementation approach’ subheading the provision for privatization projects to be initiated by either the public or the private sector.

2.2 Existing Situation in Malaysia

The Public Private Partnership Unit (PPPU) under the PMD of Malaysia was previously the privatization section under the EPU. The Unit was established in 1983 after the launch of Malaysia’s Privatization Policy as the secretariat for the Privatization Committee which comprises of members from various Government agencies with the role of evaluating and recommending privatization proposals for the Cabinet’s Approval. The PPPU’s functions are as follows:

a) legislating the policy and strategy for PPP implementation,
b) planning, implementing, coordinating, monitoring and evaluating project,
c) review and evaluate technical and financial proposal of PPP initiative with the assistance of relevant technical agency,
d) prepare and improve the guideline and procedures of PPP project implementation from time to time, and
e) negotiate the terms and conditions of the concession agreement for PPP project with the assistance of the Attorney General Chambers of Malaysia.
CHAPTER 3
TYPES OF PPP ARRANGEMENTS AND THEIR LINKAGE WITH THE SOCIO-ECONOMIC PRIORITIES

Chapter 3 covers the discussion on types of PPP projects, characteristics of PPP, sectors in which PPP projects have been undertaken and the linkages of the implementation of PPP with socio-economic priorities.

3.1 Types of PPP Projects

The PPP project comprises of privatization, Private Finance Initiative and others, and further explained as below:

3.1.1 Privatization

a) Selling assets or equities
   Transfer of assets or equities in terms of its assets, managements or responsibilities owned by Government agencies to private entities.

b) Corporatization
   Changing the status of Government agencies from public sector entities into companies incorporated under the Companies Act 1965.

c) Land Swap
   The Government will transfer ownership of suitable land of commensurate value to the company.

d) Build-Operate-Transfer (BOT)
   A private company will be granted a concession to undertake the financing and construction of a project and operate it for a designated period during which it is allowed to collect user charges.

e) Build-Operate Own (BOO)
   A private company is granted a concession to finance, develop, operate and maintain the asset without transferring the asset to the Government upon expiration of the concession period.

f) Outsourcing
   Private sector management expertise is engaged to manage facilities and services that hitherto had been provided by the Government.

g) Leasing
   A private company is granted right of use of Government assets and facilities through a lease agreement.

3.1.2 Private Finance Initiative (PFI)

a) Build-Lease-Transfer (BLT)
   A private company is granted a concession to finance and build public facilities which are then leased to the Government.

b) Build-Lease-Maintain-Transfer (BLMT)
   A private company is granted a concession to finance, build, and maintain public facilities which are then leased to the Government.

c) Build-Lease-Maintain-Operate-Transfer (BLMOT)
A private company is granted a concession to finance, build, maintain and then operate public facilities which are then leased to the Government.

3.1.3 Others

a) Facilitation Fund
A form of grant provided by the Government to attract private investment, and the objective is to bridge the viability gap of strategic projects which have the potential to generate huge spillover effect in the economy.

b) Off Take
The Government could assist by having a minimum guarantee of demand volume or operating income.

c) Joint Venture
Joint venture is funded and operated through a partnership of Government and one or more private sector companies.

3.2 Characteristics of PPP
The characteristics of PPP is quite unique, it varies across geographical and project perimeter. Arnold & Kehl (2010) listed down six inherent characteristics of PPP.

a) PPP should be a mutual interdependency between both public and private sector and the nature of this relationship must be cooperative.

b) This relationship should aim for lastingness and inclusiveness.

c) Significant portion of the shared objective in the partnership must be executed by the private sector.

d) Equal partake of the obligations in the partnership between both sectors.

e) Both sides in the partnership should pursue the mutually agreed objectives even though they both have contradictory motive.

f) The stipulation for the objective to be achieved in the partnership (infrastructure development or service) must be output-oriented or in their word “the public authority only determines what the result should be instead of regulating how the performance is realized.”

3.3 Sectors in Which PPP Projects Have Been Undertaken

Malaysia has successfully implemented 830 PPP projects as of August 2016. PPP, a smart partnership between the Government and private sector for the purpose of providing public infrastructure, community facilities and related services, had saved a total of RM222.9 billion, namely in capital expenditure of RM207.15 billion and operating expenditure of RM9.25 billion. The total proceeds from the sale of Government equities and assets were at RM6.5 billion (News Strait Times, October 14, 2016).

It covers sectors such as transportation, i.e. Kuantan Port and container terminal in Port Klang by using leasing model; infrastructure sector, i.e. Smart Tunnel and KL Tower; administrative sector, i.e. federal administrative capital in Putrajaya, and education sector, i.e. construction of university campus in Raub and Dengkil. Examples of successful PPP projects in the country are the 36 toll highways, privatization of Government office buildings in Putrajaya and 12 MARA University of Technology branch campuses in the country. PPP could deliver value for money by harnessing the private sector expertise in combining the
design and operation of an asset and providing services in a more efficient manner compared to traditional forms of procurement.

3.4 Rationale of PPP Projects with Particular Sectors and Driving Factors

The first rationale for implementing PPP is to overcome the problem of Government’s budget constraint in facing growing infrastructure need. Secondly, is on higher efficiency in projects and service delivery. Factors responsible for preferring particular types of PPP arrangements are as follows:

a) to provide world class infrastructure facilities, such as Projek Lebuh Raya Utara Selatan (PLUS) and Light Rail Transit (LRT).
b) to provide employment opportunities in the private sector in addition to producing a professional workforce, especially among Bumiputera.
c) to provide higher efficiency in projects and service delivery.
d) Government procurement can be implemented with the principles of public accountability, transparency, value for money, open and fair competition and fair dealing as its basis.
e) to provide large scale economic project.

CHAPTER 4
GENERAL RISK SITUATIONS IN PREVALENT PPP ARRANGEMENTS

Chapter 4 discusses on the possibility of risks occurred to public interests at the conception stage, and the risks to public interest in the contract management.

4.1 Risks to Public Interests at the Conception Stage of PPP Projects

The risks involved in PPP projects can be classified into financial, political and technical risk (Kumaraswamy & Zhang, 2001; Raja Abd. Karim, 2012), as below:

4.1.1 Financial Risk
There are four form of assistance from the Government which greatly help the project implementation, namely provision if foreign exchange guarantee, assistance in establishing offshore escrow account, creating off take and feedstock agreement. The basic idea of having these incentives offered by the Government is that it will aid in attracting finance source to the project as it increases lenders’ confidence to invest in it.

4.1.2 Political Risk
On the other hand encompasses a broad spectrum of risk and it is the most difficult risk element to manage. To face political risk, it was suggested having a concession agreement for a clearly stipulated time period, entering into PPP project in the form of consortium, taking political risk insurance form international agencies and having the host Government to agree for financial undertaking in the occurrence of force majeure will serve as security guaranteeing continuation and success of the project.
4.1.3 Technical Risk
This risks which can be controlled by the project sponsor themselves. Among the technical risks and their mitigation steps are construction and completion delay which suggested can be overcame with enforcing a lump sum turnkey contract for construction with experienced turnkey constructor utilizing proven technology and strictly following the stipulated time frame. For operation and maintenance risk, provision of sufficient warranty period and maintenance bonds will enable the contractor to improve any shortcoming in the construction.

4.2 Risks to Public Interests in PPP Contract Management

Risk in PPP project, like any other project, is a certainty. To mitigate the risks in PPP project, the right amount of assistance and guarantee by the Government is crucial as it will make the project more attractive to the private sector to participate. In Malaysia’s PPP project development, the Government has incorporated in the process a number of supportive measures aimed at assisting the concession company in facing the risks and ensuring the success of the projects. For example:

a) The Malaysian Government provided soft loan to support project development, traffic volume supplement, external risk supplement (exchange rate and loan rate movement guarantee, and assistance for land acquisition payment.

b) The Minimum Revenue Guarantee (MRG) which guarantees that the Government will supplement any shortfall in toll collection resulting lower than forecasted traffic volume. The MRG and the toll rate adjustment allowance have resulted in the Government paying compensation for highways which have been operating in Malaysia. The practice of MRG applied in Malaysia, where it is incorporated in the concession agreement is that the Government agrees to absorb and compensate the concessionaire company in the event of the actual toll collection revenue falls below the projected revenue.

CHAPTER 5
PREVALENT ROLES AND RESPONSIBILITIES WITH RESPECT TO AUDIT OF PPP ARRANGEMENTS

The statutory mandate to carry out audit of PPP arrangements is sufficient. Section 5 of the Audit Act 1957 stated mandate of SAI’s to carry out audit of PPP arrangements. The duties of Auditor General, which is to examine, enquire into and audit, amongst:

a) the accounts of accounting officers of the Federation and of the States;

b) the accounts of any separate fund established in a State or the Federal Territory under Article 97 (3) of the Federal Constitution notwithstanding any law to the contrary;
c) the accounts of any other public authority or body if it is so provided by law in any case; and, where it is not so provided, at the request of that authority or body and with the consent of the Minister of Finance to be notified in the gazette; and

d) the accounts of any other body, including a company registered under the Companies Act 1965, in receipt of a grant or loan from the Federation or a State, and including also a company where more than half it paid-up share capital is held by the Federation, a State or a public authority or is so held in the aggregate by two or more of them.

CHAPTER 6
AUDIT EXPERIENCE WITH RESPECT TO PPP ARRANGEMENTS

Chapter 6 explains types of audit conducted on the PPP arrangements and its objectives, audit methods used and limitations faced during the audit planning, conducting and reporting stage.

6.1 Types of Audits Conducted on PPP Arrangements

Performance auditing is the type of audit works conducted on PPP arrangements. Referring as value for money auditing, it is an independent audit of Government agency or unit, to assess the effectiveness and efficiency of its utilization of funds.

6.2 Audit Objectives Conducted on PPP Arrangements

Performance Auditing is conducted to appraise whether Government programs or activities are executed in an effective, efficient and economical manner and achieve their intended objectives.

6.3 Audit Methods Used in Audits Conducted on PPP Arrangements

Amongst audit methods used in the performance auditing conducted on PPP arrangements are:

a) Physical Inspection
   Audit evidence obtained from physical examination or inspection of tangible assets in the audited agencies.

b) Confirmation
   A confirmation request to which the recipient responds whether or not he or she agrees with the amount or information stated.
c) Documentation
   The record of audit procedures performed, audit evidence obtained, and conclusions the auditor reached.

d) Observation
   Consists of looking at a process or procedure performed by others, for example, the auditor’s observation of inventory counting by the entity’s personnel.

e) Inquiry
   This is a type of audit procedure that consists of seeking information of knowledgeable persons, both financial and non-financial, throughout the entity or outside the entity.

f) Re-performance or recalculate
   Recalculating or reconciling financial data. This process also involves redoing certain aspects of the processing of selected transactions.

g) Analytical procedure
   Evaluation of information’s through analysis of plausible relationships among both financial and non-financial data.

6.4 Limitations Faced While Planning and Executing Audit

   There are two limitations identified which will be faced while planning and executing audit work, namely:

   a) Sampling
      The application of audit procedures to less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population.

   b) Risk identification
      The risk that the auditor will conclude that the financial statements give a true and fair view and an unqualified opinion can therefore be issued when, in fact, they are materially misstated.

6.5 Limitations Faced While Reporting

   There are several limitations faced while reporting audit work, namely:

   a) Materiality
      The magnitude of an omission or misstatement of accounting information that could influence the economic decisions of users on the financial statements.

   b) Audit judgment
      An opinion derived from different audit teams and auditors which could influence the selection and evaluation of audit evidence.

   c) Critical thinking
      It is crucial skills for each auditor, and developed from the field of education where the practice of critical thinking is one of the steps in individual’s judgment.

   d) Problem solving ability
The lack of this ability to solve problems could influence auditors in identifying potential material misstatement (Bierstaker & Wright, 2001).

6.6 Limitations Faced in Implementing Audit Recommendations

Amongst the limitations identified in implementing audit recommendations is the relevancy and timeliness of the recommendations whether it is practical to be implemented within the budget and resources constraint in the audited agencies.

CHAPTER 7
VIEWS OF PPP PROJECT MANAGEMENT REGARDING AUDITS BY SAI

Chapter 7 discusses on the views regarding contribution of audit towards better project management, and suggestion regarding improvements required in audit services. Raja Abd. Karim (2012) pointed some views regarding the PPP project management as listed below:

7.1. Views Regarding Contribution of Audit towards Better Project Management
- Increase competition and transparency

Projects undertaken under the existing PPP framework in Malaysia has shown very little amount of competitive element and transparency. The preference of the Malaysian Government towards direct negotiation has resulted in increased perception of corruption and mismanagement. Therefore, for future PPP projects, competitive bidding process should be made mandatory and all decision of the Government should be made public.

7.2. Suggestion Regarding Improvements Required In Audit Services
- Management of Unsolicited Proposals

A unique aspect of Malaysian PPP project development is that the private sector is encouraged to submit project proposal to the Government (Yaacob & Naidu, 1997). The Malaysian PMP dictated that private sector can initiate privatization project by proposing to the Government the infrastructure or services to be privatized (EPU, 1991). These unrequested proposals from the private sector are termed as Unsolicited Proposal (Hodges & Dellacha, 2007).

In Malaysia’s PPP project development context, the PMP has already outlined that unsolicited proposals are acceptable for projects that are considered unique. The yardsticks for measuring uniqueness of unsolicited proposals as clarified in the PMP are the whether the proposal consists of a unique solution to an economic problem and offer with it a more economical solution to the Government, potential of saving Government’s fund and the
proposal has the unique advantage of ownership of special, proprietary technical usage rights, copy rights or knowledge which is imperative towards the implementation of the proposal that cannot be offered by any other party (EPU, 1991).

Furthermore, the PMP have also outlined how the Government should interact with unsolicited proposals, which stated that any proposal received from the private sector shall be considered on the basis of “first come, first serve” principle with the aim of rewarding innovation and ingenuity and to promote entrepreneurship. If the proposal conform to the established guidelines of uniqueness and suitable for privatization, a letter of exclusivity will be accorded to the proposer granting it the exclusive rights to undertake feasibility studies and resubmit a detailed proposal to the Government. Upon evaluation and decision that the proposal is acceptable, the Government will enter into negotiation with the proposer and award the privatization PPP project to it subject to mutual agreement being attained.

CHAPTER 8
CHALLENGES FACED IN FULFILLING THEIR ROLE AND RESPONSIBILITIES WITH RESPECT TO AUDIT OF PPP ARRANGEMENTS

Chapter 8 outlines the adequacy of legal cover, capacity issue among auditors and the issue of inadequate audit trails during the audit of PPP arrangements.

8.1 Adequacy of Legal Cover

The PPP project development in Malaysia is a case of mixed success. Based on the analysis of this research, several policy recommendations can be drawn to further strengthen the implementation process of PPP project developments among them are:

(a) Establishing a specific PPP law
The finding of this research has shown that the lack of a regulatory PPP law in Malaysia has resulted in the difficulty in implementing PPP privatization exercise effectively. The void in governing regulation has encouraged the use of discretion and subjective evaluation as basis of selection and approval of PPP projects. With a proper PPP law in place outlining all aspects of its implementation, the process from inception until the transfer back to the Government can be vastly improved.

(b) Setting up a dedicated PPP implementation agency
The current setup for PPP project development in Malaysia involves several Government agencies, i.e. PWD, MOF, MOW, AGC, PPP Unit, PMD, EPU etc. undertaking various roles which sometimes overlapped. This condition causes bureaucracy and delay in decision making. Therefore, establishing a central agency and unifying all the responsibilities for PPP implementation under the agency will greatly enhance efficiency in its implementation process.

8.2 Capacity Issues on Professional Skepticism
In identifying and assessing risks of material misstatement in the financial statements due to either error or fraudulent acts of the management, auditors are required to obtain evidence with an attitude of professional skepticism (IISAI 1240). Audit evidence is acquired by way of management enquiries, analytical procedures or observation and inspection to gain bases for identifying and assessing risks of fraudulent financial reporting (Paragraph 17 IISAI 240). When evaluating the evidence, auditors are expected to make their interpretations and critical assessment with the attitude of questioning mind which is an important component of professional skepticism.

Prior studies recognize professional skepticism as an attribute that increases auditors’ skill especially in performing fraud reporting task, and suggested that auditors with low level of professional skepticism are inclined to anchor at low level of fraud risks (Saksena, 2010). In performing audit tasks, auditors’ sensitivity over fraud increases by the exercise of professional skepticism (Carpenter & Reimers, 2013). Highly skeptical auditors are more sensitive to the possibility of management fraud. Thus, auditors who are professionally skeptical tend to set higher fraud risks compared to auditors who are less skeptical. The effect of professional skepticism attitude on auditors’ behavior in assessing risk of fraud is consistent with the social cognitive theory which asserts that auditors would be more cautious if they think and believe that there is a risk of management which involves fraudulent acts (Bandura, 1986).

Auditors with high level of professional skepticism are likely to look for sufficient information to form a basis for audit judgments. Professionally skeptical auditors would evaluate the reliability of management assertions and develop audit program. In theory, a skeptical auditor is suspicious in nature and is behaviorally driven to report fraud (Hurtt, 2010). In certain situations, auditors’ suspicious attitude leads to more skeptical actions and behavior. Hence, it is inferred that auditors with more skeptical attitude exhibit more skeptical behavior when assessing risk of material misstatement than auditors with less skeptical disposition.

8.3. Limitations in Providing Relevant Auditable Records

The issue of inadequate of audit trails due to complexity of the businesses and transactions has highlighted the importance of auditability concept, which could give an impact on the integrity practice among management. Management with higher level of integrity will disclose any information to be audited. On the contrary, for those who are lack of integrity level, will only produce minimal information requested by the auditor.

On the other hand, auditors are responsible to determine overall responses to address the assessed risks of material misstatement at the financial statement level (ISSAI 1240 and 1330). In determining to address risks, the auditor needs to evaluate whether the selection and application of accounting policies by the company, particularly those policies related to complex transactions. This kind of audit procedure in evaluating complex transactions requires auditors to consider circumstances that may indicate the possibility that the financial statements may contain a material misstatement due to error or fraud (Paragraph 29 ISSAI 240). The difficulties of auditors in searching for the adequate evidences might
delay the audit process in which might reflect the ineffectiveness of the companies in maintaining their records for the audit purposes.

Nowadays, most business organizations are facing issues related to the complexity of the transactions, due to the current business environment. Transactions appear overly complex, involving multiple companies within a consolidated group or multiple unrelated third parties. This scenario becomes more complicated when involving business transactions in different countries. The nature and complexity of the accounts may be affected inappropriate journal entries or adjustments. It is also requires auditors to consider those accounts which contain a complex or an unusual transaction, and could be an indicator of misstatement in financial reporting.

In considering assessment of any misstatement during audit work, internal control systems need to be efficient and effective. The effectiveness of internal control system helps an organization in minimizing all the risks particularly for auditors. Internal control system over financial reporting has long been recognized as an important factor of a company to ensure the reliability of financial reporting. Among indicators for an effective internal control system are transactions are recorded properly and on a timely basis. For a complex or an unusual transaction, the management needs to prepare and provide an adequate audit trails or additional evidences that may be necessary to convince the auditors in forming their opinions.

Audit trails should be easy to assess, depending on the complexity involved in the particular transactions. For example, conducting an audit trail on an invoice issued by a vendor would be relatively simple process. An audit trail usually begins with the invoice receipt. The transactions is then followed back through accounts payable and finally through to the check or electronic payment made to settle the amount. However, an audit trail may contain many more steps and be difficult to follow, depending on the complexity of the transactions.

Current studies such as Rendon and Rendon (2015) allege that the ability of the companies to provide an adequate audit trails or additional evidences that may be necessary are not seriously being emphasized, particularly in today's business environment. In fact, the need for companies to provide additional evidences nowadays is increasingly demanded in line with the increase in the financial scandals.

CHAPTER 9
OVERALL CONCLUSIONS

The evaluation of success or failure of the implementation of PPP project development in Malaysia should not be based solely on the achievement of Malaysia’s privatization objectives. Objective review should be made on all other aspects of the implementation. From these reviews conducted, glaring findings have been made on aspects of implementation which does not fit well with the success story of the PPP projects. As such, to determine whether the PPP project development in Malaysia is a success or failure requires a careful, balanced evaluation of what has been perceived as success and what has been the opposite. It can be said that PPP project development in
Malaysia has been a resounding success. However, if the sustainability of the model is being used as the yardstick in measuring the success, then the implementation model applied in Malaysia is far from successful. It is difficult to term the Malaysian PPP project development a success if the Government has to provide continuous protection to the concession company to shield it from risk while simultaneously guaranteeing the latter’s profit.

CHAPTER 10
GENERAL RECOMMENDATIONS

The PPP project development in Malaysia is a case of mixed success (Raja Abd. Karim, 2012). Based on the analysis, several policy recommendations can be drawn to further strengthen the implementation process of PPP project developments among them are

(a) Establishing a specific PPP law
The findings of this research have shown that the lack of a regulatory PPP law in Malaysia has resulted in the difficulty in implementing PPP privatization exercise effectively. With a proper PPP law in place outlining all aspects of its implementation, the process from inception until the transfer back to the Government can be vastly improved.

(b) Setting up a dedicated PPP project implementation agency
The current setup for PPP project development in Malaysia involves several Government agencies undertaking various roles which sometimes overlapped. This condition causes bureaucracy and delay in decision making. Therefore, establishing a central agency and unifying all the responsibilities for PPP project implementation under the agency will greatly enhance efficiency in its implementation process.

(c) Better management of unsolicited proposals
The existing implementation process in Malaysia allows for unsolicited proposal to be submitted for the Government’s consideration and most of the time, the evaluation result favours the proponents of such proposals. Upon careful review, it is clear that a number of the PPP projects which resulted from unsolicited proposals lack the innovation and unique features to justify its selection. Some of the projects are simple upgrading of existing alignment or construction which does not require special technical know-how or proprietary technology and can simply be implemented under conventional procurement system. Thus, it is recommended that the criteria for unsolicited proposals be tightened such as limiting it only for highly innovative project and brownfield projects such as water supply infrastructure.

APPENDIX: COUNTRY PAPER
THE RELATIONSHIP BETWEEN CULTURAL DIMENSIONS AND FRAUD RISK ASSESSMENT

ABSTRACT

Auditors’ judgment is a critical component in assessing risks of fraud. A poor application of auditors’ judgment has resulted due to individual experience and
differences in cultural dimensions in any audit organizations. This study examines the relationship between auditors' experience, in-group collectivism, power distance and assessment of risk of fraud. Results from the survey confirm that auditors' experience affects significantly and positively the assessment of risk of fraud. The significant negative relationships exist in in-group collectivism and power distance cultural dimensions. Results are expected to help formulate clear guidelines on the application of audit judgment within the organizational environment. This study is examined based on individual auditors' assessment of risk of fraud. In a real situation, the assessment is performed by audit teams.

Keywords: fraud risk assessment; auditors' experience, in-group collectivism; power distance

1.0 INTRODUCTION

Research in psychology demonstrates that auditor's judgment and decision making can be influenced by environmental factors, including culture (Roberts et al. 2003). Given the importance of judgment and decision making among auditors and the roles of various environmental factors in influencing the development of individual's trait, our study aims to investigate the roles of one of the environmental factors, culture on auditors judgment. Belkaoui (1995) promotes the idea that culture determines the manner in which organizations are structured and managed, the behavior of individuals within these organizations as well as how these individuals think. Hence, in the context of audit, auditors' ability to maintain their judgment could be influenced by the cultural environment which they are attached to.

Hurtt et al. (2013) emphasize on the need for future research to investigate the potential influence of culture on auditors' cognitive, including the roles of corporate culture. In line with the suggestion by Hurtt et al. (2013), this study examines this issue by looking at the roles of culture in influencing their assessment of fraud risk. Overwhelming evidence in the literature that consistently demonstrates the influence of culture on the judgments and behaviors of accountant and auditors renders it necessary to investigate the influence of this variable on fraud risk assessment (Jenkins et al. 2008). If culture influences auditors' mindset, then auditors from different cultures will have different sensitivity to fraud risk despite adhering to the same auditing standards. This will influence their risk assessment that, in turn, leads to differences in audit quality.

In addressing the above issues, this study conducts a survey. The objective of the survey is to explore the relationship of experience and culture on auditors’ fraud risk by embracing literature from psychology, in particular those of Hofstede (2001) and House et al. (2004). Based on the literature and the discussion in Hurtt et al. (2013), cultural environment may influences auditors’ judgments. This study identifies two cultural dimensions that are most likely influencing auditors’ risk assessment, namely in-group collectivism and power distance (Mustamil and Quaddus 2009).

The survey uses social cognitive theory to link and predict the relationships between in-group collectivism, power distance and fraud risk assessment. This study examines the
hypotheses that involve a sample of auditors from National Audit Department of Malaysia. Questionnaires were distributed by on line survey in approaching respondents.

The findings indicate a significant relationship of experience, in-group collectivism and power distance on auditors’ fraud risk assessment. This study makes a number of contributions to the audit practice. The findings of this study provide important inputs in obtaining deeper understanding of the potential influence of different aspects of cultural dimensions on auditors’ fraud risk assessment. The findings related to the influence of one aspect of organizational culture, in-group collectivism, on auditors’ fraud risk assessment would be of interest to auditing professional in general. The related parties may need to take these findings into consideration when developing in-house training and designing more effective audit review process.

2.0 THEORY, LITERATURE AND HYPOTHESIS DEVELOPMENT

This section discusses the auditors’ responsibility with regard to fraud risk assessment and how the assessment process is influence by culture. This section addresses culture in two dimensions, in-group collectivism and power distance. This section also addresses how in-group collectivism and power distance directly affect auditors’ fraud risk assessment. Hypotheses are developed to test the relationships between variables discussed.

2.1 Social Cognitive Theory

This study uses the Bandura (1986) social cognitive theory to explain auditors’ behavior in obtaining audit evidence and reacting towards the social environment of audit organization. The social cognitive theory acknowledges both the social and cognitive aspects of human behavior. The theory combines the social origins of human thought and action with what individuals learn by being part of a society and the cognitive process to human motivation, attitudes and action, and what individuals recognize as the influential contribution of thought processes (Stajkovic and Luthans 1998).

In order to understand differences in behavior among individuals in the work environment, the social cognitive theory clearly specifies factors which determine human actions. The theory explains the human behavior in terms of reciprocal causation between the personality and behavior of an individual, and the environment. The triangular relationships between personality, behavior and environment, do not necessarily imply symmetry in the strength of bidirectional influences between points on the triangle (Bandura 1986). The strength of mutual influences between any of the two factors is not fixed in reciprocal causation. Although all three factors may be present at any particular time and in any particular environment, they may not exert an equal and simultaneous influence on the individual (Strajkovic and Luthans 1998). Thus, the influence exerted by one, two, or all the three interacting factors on human behavior may vary depending on activities, individuals and circumstances (Strajkovic and Luthans 1998).

According to Peytcheva (2014), exercising and implementing the attitude of audit judgment and decision making are parts of cognitive process. Cognitive process means any
activity which involves mind processing such as thinking, reasoning, analyzing, conceptualizing and problem solving. Thus, auditors with professional judgment go through the cognitive process by asking questions continuously in order to acquire enough audit evidence. The practice of professional judgment in acquiring adequate evidence is among procedures that auditors use for the purpose of fraud risk assessment.

The social cognitive theory emphasizes that the significant influence of cognitive process, environmental factors and individual behavior is a function of human life. The application of social cognitive theory in this study is relevant in explaining the auditors’ behavior to assess the risk of fraud which is expected to vary depending on the individuals’ cognitive process and working environment represented by the culture.

2.2 Auditors’ Responsibility

The main responsibility of auditors is to verify the company financial statements and to form an opinion on whether the financial statements present a true and fair view on the performance and financial position of the company (Paragraph 3 ISSAI 1200). In carrying out the responsibility, auditors are required to assess risks of misreporting due to error or fraud.

The verification function of auditors on financial statements is clearly defined in the ISSAI 1200 on Overall Objectives of the Independent Auditor and the Conduct of an Audit, in accordance with International Standards on Auditing. The verification of financial statements by auditors is expected to enhance the degree of confidence of financial statement users on audited financial statements. An audit opinion is formed based on the evaluation of evidence gathered from the selected audit sample and the quality of assertions to meet specific criteria on the reliability of the financial statements (Amerongen 2007).

Auditors’ reliance on the sampling procedure and audit evidence from the sample fetches the possibility of risk of undetected material misstatements. The existence of risk of undetected misstatements reduces auditors to only expressing opinion with reasonable assurance that the financial statement is free from material misstatements. A reasonable assurance is issued after sufficient and appropriate audit evidence reduces audit risks are obtained. Paragraph 5 of ISSAI 1200 stated that auditors may face risks of expressing inappropriate opinions on the financial statements.

2.3 Auditors’ Assessment of Fraud Risk

The role auditor is determined by the audit standard, which is to identify and assess the risks of material misstatement either due to error or fraud (Paragraph 16 ISSAI 1240). The auditor shall perform risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatement at the financial report. Risk assessment procedures shall include enquiries of management, analytical procedures or observation and inspection (Paragraph 17 ISSAI 1240). Risk assessment procedures, however, may not provide sufficient appropriate audit evidence upon which the audit opinion is based. The auditor shall consider whether information obtained from the client is relevant to identifying risks of material misstatement.
Material misstatement in financial statements may occur either due to unintentional errors or intentional fraudulent acts by the management during accounting record keeping and preparation of financial statements. Paragraph A1 ISSAI 1240 defines error as an unintentional misstatement in financial statements, including the omission of an amount or a disclosure, such as a mistake in gathering or processing data from which financial statements are prepared or a mistake in the application of accounting principles relating to presentation or disclosure. The same standard defines fraud as an intentional act by one or more individuals among management involving incentives or pressure to commit fraud, a perceived opportunity to do so and some rationalization of the act. The standard highlights two types of misstatement arising from fraud which are relevant to auditors. These misstatements arise from misappropriation of assets or fraudulent financial reporting (Paragraph A3 ISSAI 1240). Misappropriation of assets involves the theft of an entity’s assets. Fraudulent financial reporting involves intentional misstatements including omissions of amounts or disclosures in financial statements to deceive financial statements users (Paragraph A2 ISSAI 1240).

In this study, the focus is assessing the risk of misstatement resulting from fraudulent financial reporting. Stirbu et al. (2009) claims that fraudulent reporting in the financial statements is of great concern not only to the management, but also to the audit profession. Stirbu et al. (2009) argue that fraudulent financial reporting undermines auditors’ credibility in their reporting function and erode public confidence in the audit profession. Auditors undoubtedly contribute to the recent corporate frauds by certifying financial statements that ultimately proved to be fraudulent or at least defective (Ribstein 2002). Dyck et al. (2010) and KPMG (2013) find that independent auditors report only around 10% of frauds. As a result, the public may question on why auditors are unable to report the likelihood of fraud during the conduct of the annual audit.

The primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and with management. It is important that the management, with the oversight of those charged with governance place a strong emphasis on fraud prevention. A stern action by the management may reduce opportunities for the occurrence of and increase fraud deterrence. The right environment could convince individuals not to commit fraud because of the likelihood of detection and punishment. Correct environment comprises the culture of honesty and ethical behavior. A culture that is based on a strong set of core value communicated and demonstrated by the management and by those charged with governance and provide the foundation for employees in the conduct of a business (Paragraph 4 ISSAI 1240).

Although auditors are not responsible on prevailing fraud, Paragraphs 4 to 8 of ISSAI 1240 require auditors to give a serious attention on the possibility of fraud occurrence due to several reasons. Firstly, auditors need to obtain reasonable assurance that the financial statements taken as a whole are free from material misstatements caused by fraud. Secondly, auditors should bear in mind that the risk of not reporting a fraud is higher than the risk of not detecting an error since fraud may involve sophisticated and carefully organized acts. Thirdly, as auditors, they should bear in mind that the risk of not reporting management fraud is greater than employee fraud because the management is frequently in a position to directly or indirectly manipulate accounting records. Lastly, when obtaining
reasonable assurance, the auditor is responsible for maintaining professional judgment throughout the audit.

2.4 The Relationship of Experience

The experience of auditors in reporting fraud is important because it improves auditors’ understanding of various aspects and challenges related to assessment of risk of material misstatement of fraud (Knapp & Knapp 2001). Thus, in assessing risk of material misstatement, an experienced auditor makes more thorough assessment and more accurate judgments and decisions on matters related to fraud compared to a less experienced auditor. Past experience in the assessment of risk of material misstatement is expected to give a better input to the auditor when given assignment to detect fraud. Past studies show that auditors’ experience positively affects assessment of risk of material misstatement due to fraud (Knapp & Knapp 2001). Experienced auditors assist and lead a fraud investigation whenever there are opposing opinions among the audit team members. Differences in opinions may occur as a result of the method of audit investigation used in trailing fraud evidence. Payne and Ramsay (2005) found a contradictory finding. Experienced auditors have failed to make better assessment of risk of material misstatement due to fraud when compared to less experienced auditors. These mixed findings warrant for further investigation in order to resolve this discrepancy.

Past studies on the relationship of auditors’ experience on work performance are mixed. Based on the theory of social cognitive (Bandura 1986) it is expected that experience of auditors positively influence assessment of risk of material misstatement. This assertion is consistent with Knapp & Knapp (2001) who find positive relationship of experience on auditors’ assessment of risks. Based on the above discussions the following hypothesis has been developed to test the relationship between experience and assessment of risk of material misstatement.

H1: The auditors’ experience is positively related to the auditors’ assessment of risk of material misstatement.

2.5 Culture

This section discusses the definition of culture followed by discussions on in-group collectivism and power distance cultural dimensions (Hofstede 1991; House et al. 2004). This section also reviews the influence of culture on fraud risk assessment.

2.5.1 Defining Culture

Culture is defined as software of mind or collective programming of the mind that distinguishes members of one group, or category of people from other groups or categories (Hofstede 1991). Culture can also be viewed both in terms of what one does and or how one thinks, based on beliefs, traditions, customs, norms and even religion (Hofstede 1991). Hofstede (1991) suggests that individuals learn and observe cultural value shared in organizations, groups, and this becomes the foundation of the individual’s behavior.
Hofstede’s cultural dimension has been widely referred to by many studies that examine country and organizational culture (Vitell et al. 1993). In his study, Hofstede (1991) employed 117,000 respondents from 67 countries and proposed a five-dimensional cultural framework to explain cultural practices: namely power distance, uncertainty avoidance, individualism/collectivism, masculinity/femininity and long term orientation.

Hofstede’s five-dimensional cultural framework has received many criticisms because data of the study was collected from only one company across different countries, namely International Business Machines Corporation (IBM). This has created a respondent bias in the study (Javidan et al. 2006). In response to this criticism, House et al. (2004) took the initiative to conduct an extended but a complimentary study to describe the more recent dimensions of culture. The main difference between Hofstede’s cultural studies with that of House et al.’s study was that Hofstede (1991) investigated cultural differences at country level. On the other hand, House et al. (2004) has investigated the same issue at the organizational level. This Global Leadership and Organizational Behavior Effectiveness (GLOBE) study defines culture as shared motives, values, beliefs, identities, and interpretations or meanings of significant events that resulted from common experiences among collective members that are transmitted across generations (House et al. 2004).

The GLOBE study was conducted on 17,300 managers from 951 organizations with 62 countries. The research project has identified nine dimensions of culture, which are performance orientation, future orientation, assertiveness, power distance, human orientation, institutional collectivism, in-group collectivism, uncertainty avoidance and gender egalitarianism. These nine cultural dimensions are investigated at the organizational level. The study found that cultures can be differentiated on the basis of the leader behaviors and attributes as endorsed by their members (House et al. 2004).

The Hofstede (1991) and House et al. (2004) studies have identified two cultural dimensions, namely, the in-group collectivism and power distance that are consistently significant in explaining cultural differences at the country and organizational levels. In-group collectivism identifies the degree on which individual expresses their pride, loyalty, and cohesiveness in their organizations or families. Power distance on the other hand shows the degree to which members of an organization or society expect and agree that power should be unequally shared. Therefore, it is logical to expect that the same cultural dimension would be able to explain the similarities and differences in the application of globally accepted auditing standards by different auditors from different countries.

Endrawes and Monroe (2012) also use these two culture dimensions to examine the differences in the application of auditor judgments, decisions and professional scepticism between auditors in Australia and Egypt. The results show that the significant difference in decision making behavior between auditors of these two countries may be explained by the two cultural dimensions. These results also support the earlier results by Endrawes and Matawie (2002) who suggest different countries are significantly different in auditors’ judgment on these two cultural dimensions.

In-group collectivism and power distance cultural dimensions of auditors has also been investigated by Hope et al. (2008), Sim (2010) and Ahmad et al. (2014). Belkaoufi (1995)
stressed the idea that culture determines the judgments and decisions made by individuals. Therefore, the outcome of the judgment and decision process is relative to the culture in which it is made. However, these culture dimensions have not been tested on fraud risk assessment among auditors. Therefore, this study examines the role of these two cultural dimensions (in-group collectivism and power distance) in assessing fraud risk.

2.5.2 Significance of Culture on Fraud Risk Assessment

The influence of culture on the behavior and action of individuals has been theorized by Ferrel and Gresham (1985) and Dubinsky and Loken (1989). According to Ferrel and Gresham (1985), individuals’ action and behavior, for example in assessing fraud risk, is influenced by culture which is embedded in the society and organization in which individuals are a part of. Culture affects people through their perceptions of what is consensually believed and places boundaries by defining what appropriate and inappropriate actions.

There are many past studies that examine culture from the accounting perspective (Harrison & McKinnon 1986; Gray 1989; Doupnik & Tsakumis 2004). Harrison and McKinnon (1986) viewed accounting as a social system and examined the influence of culture on accounting practice in Japan. Harrison and McKinnon (1986) found that culture affects accounting practice through its influence over the norms and values held by individuals and groups within the social system. Gray (1988) extended the Harrison and McKinnon’s idea by proposing that accounting exists as a sub-culture within the social system and postulated that accounting practices and values that make-up the accounting sub-culture, have an effect on the authority and the enforcement of the accounting system as well as the system’s measurement and disclosure characteristics. According to Doupnik and Tsakumis (2004), even if all countries were to adopt a single set of financial reporting standards, there may still be some differences in the application of these standards by individual accountants due to influence of culture. Culture is therefore a compelling construct in explaining and predicting accountants’ and perhaps auditors’ behavior.

The auditing literature reports that an audit is a social product that is influenced by working environment, group and individual behavior (Flint 1988). Working environment covers cultural environment which influences values and judgments of individuals in different countries (Cohen et al. 1996). It has been recognized in the auditing literature that values and judgments of auditors are significant in their behavior and action to judge and make audit decision (e.g. Nolder and Riley 2014). Studies have been conducted to determine how auditors respond towards fraudulent financial reporting behavior (Murphy et al. 2011; Albrecht et al. 2011; Schmidt 2011). Murphy et al. (2011) for example, conducted a study to examine culture as an indicator of fraud, so that auditors can plan audit program relating to fraud risk assessment. Result suggests that culture should be explicitly woven into the fraud triangle. Fraud triangle comprises three factors (opportunity, incentive or pressure, and individuals’ attitude or rationalization) that predict the likelihood of fraud occurs within an organization (Albrecht et al., 2011). Schmidt (2011) surveyed 115 auditors to examine how auditors construct their mental representations and test hypotheses about the strength of a client’s control environment. The result shows that the retrieval of control environment information from memory biases an auditor’s mental representation, and this biased mental representation influence subsequent fraud assessment.
Despite the assertion of cultural influence in individuals’ beliefs and behavior, analysis of how culture influences the judgment among auditors is still relatively unexplored. Furthermore, there is also lack of studies that integrate the cultural values towards fraud risk assessment. The current study attempts to analyze the relationship between in-group collectivism and power distance cultural dimension respectively in dealing with fraud risk assessment.

2.5.3 The Relationship of In-Group Collectivism

This study is to examine the relationship of in-group collectivism cultural dimension. The relationship of culture on individual behavior was asserted by Maanen (1978) who proposed that when individuals join an organization, they have to realign their system of beliefs within the organizational setting. Individuals are most likely to conform to the system that provides the most applicable and relevant information of behavioral conduct, which also include auditors’ action and behavior. As a result, this process leads to certain behavioral results in an organization, most likely based on the standard behavior. Therefore, any inconsistency in individual beliefs is adjusted and modified according to the organizational practices. This notion was supported in a study by Douglas et al. (2001) who found that individuals in an organization adjust their internal values based on their moral philosophy in order to share the common values among other individuals in the organization.

Hofstede (1984) indicated that people in individualistic culture tend to be more creative than people in collectivist culture. Individuals in individualistic culture perceive the self as stable and the environment as changeable (Su et al. 1999). In contrast, individuals in collectivist nations perceive the environment as stable and themselves as changeable (Chiu & Hong, 2006). In an auditing environment, an auditors’ decision in individualistic culture are expected to depend more on their skills to critically assessing audit evidences. Therefore, an individual auditor is accountable for his or her action and decision. The emphasis on auditors’ personal responsibility determine their behavioral towards fraudulent financial reporting. It is claimed that in individualistic culture auditors are more likely to have more careful in assessing audit evidence and more likely to detect an attempt of fraudulent reporting.

On the other hand, auditors in collectivist culture (or high in-group collectivism dimension) will be more dependent on the norms, conditions and social structures under which the decision is made. The responsibility of one auditor’s action and decision rests on the whole group members. Since, the responsibility is borne by the whole members; individual auditors are expected to be less critical in assessing audit evidence. Therefore, it is expected that auditors from high in-group collectivism dimension would have lower level of fraud risk assessment.

Therefore, the following hypothesis is proposed:

H2: In-group collectivism culture has a negative relationship on fraud risk assessment.
2.5.4 The Relationship of Power Distance

This study is also to examine the relationship of power distance cultural dimension on fraud risk assessment. In any organizations, the inequality of power can be assumed because personnel or staff behaves in accordance with their hierarchy in an organization (House et al. 2004). In high power distance culture organization, the staff is expected to show loyalty, obey their superiors uncritically, use formal standards for ethical conduct, and support the status quo (House et al. 2004). On the other hand, in organization with low power distance culture perceived power as a source of corruption, coercion, and dominance (House et al. 2004).

Power distance culture refers to the acceptance of inequality in power (House et al. 2004, Hofstede 1991). Superiors or top management in the high power distance culture behave in a more autocratic manner and demand no consultation from subordinates (Hofstede 1991). Thus, auditors in firms with high power distance culture tend to obey and follow instructions from their superior in order to avoid disagreements and to satisfy and impress their superiors (Karande et al. 2002). In other words, auditors in high power distance culture are not innovative in gathering audit evidences. They tend to follow audit check lists religiously as required by their superiors. Therefore, auditors in high power distance culture firms tend to be less skeptical compared to auditors in low power distance culture.

Based on the above discussions, it is expected that auditors in a high power distance culture firms would be less likely to have high fraud risk assessment in carrying out their audit engagement. Therefore, the following hypothesis is developed:

H3: Power distance culture has a negative relationship on fraud risk assessment.

3.0 THE SURVEY

The survey involves distribution of questionnaire to the selected auditors in NAD of Malaysia.

3.1 Sample

The unit of analysis is individual auditors. This study applies to auditors in Federal and Federal Authority Sector and all Audit States from three different levels of auditors, i.e. supporting staffs, junior and senior auditors/managerial level. The sampling frame is based on the auditors in NAD totaling to 1,200 auditors as at 30th June 2015 (NAD’s System Directory).

3.2 Collection of Data
The questionnaires were mailed to the respective participants by email, with a cover letter stating the study objectives and assuring anonymity and confidentiality. Three weeks after the initial mailing, a softly reminder was made and a follow-up email was sent to the participants to remind him or her to mail them back to the researcher.

Participation in the study was voluntary and respondents were assured that all results would remain confidential and that there was no right or wrong answers. These details were included in the written instructions on the cover page to the questionnaire and were repeated verbally to the person in charge when the questionnaire was distributed. The rationale for these instructions was to attenuate the social desirability response bias that may occur in research (Cavana, et al. 2001). The respondents are also advised not to discuss questions and answers with their colleagues. This is to increase the internal validity as any discussions among respondents may cause a potential bias of answers.

3.3 Research Instrument

Research instrument comprises a cover letter and a research booklet. The cover letter provides a brief description of the study and a request for participation. The booklet includes three main sections. Section A comprises audit task on fraud risk assessment. Section B contains the instrument to measure in-group collectivism and power distance culture. Lastly, Section C is about respondent’s profile. The instrument requires approximately 7 minutes to be completed.

Section A: Fraud Risk Assessment Case

The dependent variable is measured using question on fraud risk assessment based on a given case description. The case study which is adapted from Quadackers (2009) describes a situation in a planning stage i.e. analytical procedures setting. This setting is chosen because the analytical procedures have been identified as an effective technique to determine the probability of misstatement of financial reporting and the likelihood of fraud (Erickson et al. 2000). The case study employed contains an unexpected material increase in gross margin. Since client is the main source of explanations concerning unexpected fluctuations while conducting analytical procedures, auditors should evaluate client’s explanations with sufficient level of judgment (Trompeter and Wright 2010; Glover et al. 2000).

The use of case study is to identify the respondent’s perspective on what is the likelihood that sales figure were reported incorrectly from the range of 0 to 100%. The audit task adapted from Quadackers (2009) is appropriate to be used in this study since it has been developed by taking into consideration a number of situations which is relevant to the audit work environment. Firstly, fraudulent cases have been successfully reported by auditors during analytical review procedures at the audit planning stage (Peecher 1996; Erickson et al. 2000). Secondly, many fraud cases involve the gross margin reporting for accounts receivable and sales in the company’s financial statements (Braun 2000). Thirdly, Loebbecke et al. (1989) and Mitchell (1997) found that cases of fraud mostly involving accounts receivable and sales.
Section B: In-Group Collectivism and Power Distance Culture Measurement

In this Section, respondents are required to indicate their level of agreement to 14 items used to measure the level of in-group collectivism and power distance. The fourteen items has been used by Mustamil and Quaddus (2010) and are derived from both studies of House et al. (2004) and Hofstede (1980, 1991).

Seven out of 14 items are used to measure the practice of in-group collectivism culture, namely harmony, loyalty, pride in group member’s accomplishment, team oriented, compensation, personal relationship and saving face. Whereas, the remaining seven items are used to determine the practices of power distance, namely inequality, obeying leaders, position importance, respectfulness, centralization of power, formal rule and hierarchical system.

Section C: Respondents’ Profile

Finally, this Section asks for the descriptive information of the respondents as to provide an understanding of the respondents’ background. Among the information collected are on respondent’s gender, education background, current position, type of audit firm, the number of audit partners, years of service, the number of fraud experience, if any, previously encountered and fraud related courses attended by respondents.

3.4 Operationalization of Variables

Variables of this study are assessment of risk of material misstatement as the dependent variable, auditor experience, in-group collectivism and power distance as an independent variables. The assessment is made based on the management’s explanation on the change in sales mix which accounts for the increase in the gross margin (Payne and Ramsay 2005). Respondents are expected to put a likelihood percentage that sales figure were reported incorrectly. Table 1 summarizes operationalization of variables.

<table>
<thead>
<tr>
<th>Variables</th>
<th>Operationalization</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assessment of Risk of Material Misstatement</td>
<td>Participants’ assessment on the likelihood percentage of sales figure were reported incorrectly (Payne &amp; Ramsay, 2005).</td>
</tr>
<tr>
<td>Experience</td>
<td>Participants’ statements on the present position level (supporting staffs, juniors or seniors/managers) (Owusu-Ansah et al., 2002).</td>
</tr>
<tr>
<td>In-Group Collectivism; Power Distance</td>
<td>Participants’ reaction on the time allocated to perform audit tasks ranging from 1 (never) to 6 (always) on seven items of identifying the level of in-group collectivism (Mustamil &amp; Quaddus, 2009).</td>
</tr>
</tbody>
</table>
4.0 RESULTS AND DISCUSSION

The survey report conducted as to meet the stated objectives and hypotheses of the study. Section 4.1 provides descriptive statistics of respondents, followed by Section 4.2 which discusses the results of the analysis and discussions of the findings.

4.1 Descriptive Statistics of Respondents

The sub-sections below discuss the details of the respondents of this study including the response rate and the demographic profile of the respondents.

4.1.1 Response Rate

The response rate is calculated as the percentage of the number of usable and returned questionnaires to the number of questionnaires sent. All 1,400 auditors were selected from the Federal and Federal Authority Sector including all the Audit State in Malaysia. Of the 1,400 questionnaires sent out in Malaysia, 182 completed questionnaires were returned. The questionnaires were reviewed to seek out errors in the form of invalid data including blank questionnaire or missing values. This procedure was carried out to produce clean data for the research analysis (Hair et al. 2010). Upon reviewing, 23 of the returned questionnaires were excluded from the analysis because of missing values. As a result of this cleaning procedure, 159 usable questionnaires were finalized which represents a 13.3% response rate. Thus, the response rate in this study is considered adequate.

Table 2 shows the number of questionnaires distributed and response rate.

<table>
<thead>
<tr>
<th>Number of Questionnaire</th>
<th>N</th>
<th>Min</th>
<th>Max</th>
<th>Mean</th>
<th>Std Dev.</th>
<th>Range</th>
</tr>
</thead>
<tbody>
<tr>
<td>Questionnaire Distributed</td>
<td>1,200</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Questionnaire Received</td>
<td>182</td>
<td>(15.2%)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Usable Questionnaire</td>
<td>159</td>
<td>(13.3%)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

4.1.2 Descriptive Statistics

Table 3 presents descriptive statistics of variable in this study.

Table 3: Descriptive Statistics

<table>
<thead>
<tr>
<th>N</th>
<th>Min</th>
<th>Max</th>
<th>Mean</th>
<th>Std Dev.</th>
<th>Range</th>
</tr>
</thead>
<tbody>
<tr>
<td>159</td>
<td>3.43</td>
<td>6.00</td>
<td>4.69</td>
<td>.533</td>
<td>1-6</td>
</tr>
</tbody>
</table>
Power Distance

<table>
<thead>
<tr>
<th>Assessment of Risk of Material Misstatements</th>
<th>159</th>
<th>1.14</th>
<th>6.00</th>
<th>4.32</th>
<th>.765</th>
<th>1-6</th>
</tr>
</thead>
</table>

4.1. Profile of the Respondents

Descriptive analysis is conducted to understand the respondent’s demographic background. In total, the sample comprises of 159 auditors who worked in different Sectors throughout Malaysia.

Table 4 presents selected demographic characteristics of respondents in this study.

<table>
<thead>
<tr>
<th>Table 4 - Profile of the Respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>N=159 file</td>
</tr>
<tr>
<td>Gender</td>
</tr>
<tr>
<td>Male 47</td>
</tr>
<tr>
<td>Female 112</td>
</tr>
<tr>
<td>Academic Background</td>
</tr>
<tr>
<td>Diploma 46</td>
</tr>
<tr>
<td>Bachelor Degree 81</td>
</tr>
<tr>
<td>Master 18</td>
</tr>
<tr>
<td>Professional 8</td>
</tr>
<tr>
<td>Others 6</td>
</tr>
<tr>
<td>Present Position Level</td>
</tr>
<tr>
<td>Supporting 83</td>
</tr>
<tr>
<td>Junior 52</td>
</tr>
<tr>
<td>Senior 24</td>
</tr>
</tbody>
</table>

Note: F = Frequency

Out of 159 auditors in Malaysia, there are 47 male auditors (29.6%) and 112 female auditors (70.4%). In terms of academic background, four groups were formed to represent educational level of respondents. Level one represents the diploma level which is the lowest academic qualification followed by bachelor degree, master and professional qualification such as CIMA or ACCA. There are 81 auditors (50.9%) who have a bachelor degree. The statistic also shows that the percentage of respondents who have bachelor degree is more than other academic qualification. As shown in Table 2, the supporting and junior auditor position made up the largest respondents in Malaysia (135 auditor representing 84.9%) of total respondents.
4.2 Multiple Regression Analysis

Multiple regression analysis is used to predict the value of a variable based on the value of two or more other variables. The variable to predict is called the dependent variable or the outcome. The variables used to predict the value of the dependent variable are called the independent variables or the predictor. Multiple regression analysis can be used to determine the overall fit, variance explained of the model and the relative contribution of each of the predictors to the total variance explained.

4.2.1 Test of Data

Test of data covers checking the multicollinearity test and reliability of the data. Multicollinearity test through correlation analysis and collinearity statistics should be examined before interpreting the output from multiple regression analysis. Correlation refers to the relationship among the independent variables. Multicollinearity exists when the independent variables are highly correlated (r=.9) and above. In this case, the correlation between each independent variable should not too high (less than .7). Correlation matrix result shows that the highest correlation value is 0.171 which is way below 0.7.

Table 5 shows the correlation between variables in this study.

<table>
<thead>
<tr>
<th></th>
<th>Fraud Risk Assessment</th>
<th>In-Group Collectivism</th>
<th>Power Distance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fraud Risk Assessment</td>
<td>1.000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>In-Group Collectivism</td>
<td>-0.199**</td>
<td>1.000</td>
<td></td>
</tr>
<tr>
<td>Power Distance</td>
<td>-0.188*</td>
<td>0.107</td>
<td>1.000</td>
</tr>
</tbody>
</table>

*, ** Significant at 5% or 1% levels.

The reliability test is performed to determine the internal consistency and stability of the measuring instrument (Sekaran, 2005). One of the most commonly used indicators of internal consistency is Cronbach’s alpha coefficient. Ideally, the Cronbach’s alpha coefficient of a scale should be .70 and above (Hair et al., 2010). The results of reliability test indicate that in-group collectivism having (.665 cronbach alpha) and power distance (.739 cronbach alpha), which considered adequate.

4.2.2 Results

Multiple regression analysis was conducted in order to understand the impact of the independent variables on fraud risk assessment. A summary of the analysis is provided in Table 6.
Table 6 shows the result for the model of the study. The model explains the relationship between experience and cultural dimensions (in-group collectivism, power distance) with fraud risk assessment. Based on the Table 5, results suggest that hypothesis 1, hypothesis 2 and hypotheses 3 are accepted. The discussion of the results is discussed as follows:

(a) The Relationship of Experience

Hypothesis 1 examines the relationship of auditors’ experience towards fraud risk assessment. The result shows positively significant the relationship between experience and fraud risk assessment ($B = .130, p < 0.1$), thus hypothesis 1 is accepted. Experienced auditors have better knowledge in audit investigation. They execute more effective investigation techniques and are more efficient in identifying indicators of material fraudulent misstatements (Braun 2000).

(b) The Relationship of In-Group Collectivism

The objective of hypothesis 2 is to examine the relationship of in-group collectivism culture towards fraud risk assessment. The result indicates that the hypothesized relationship for in-group collectivism and fraud risk assessment is negatively significant ($B = -.185, p < 0.05$). Thus, hypothesis 2 is accepted. It shows that auditors tend to place higher risk when they are working in organizations with more individualistic (less in-group collectivism) culture. Auditors who are working in more individualistic culture are expected to make fraud risk assessment based on their own beliefs, values and attitudes. It depends on their skills to critically assess audit evidence and they are accountable to their decisions.
Hence they are found to be more effective in detecting the risk of financial misstatement. Whereas, auditors who are working in more collectivist culture depend more on norms, situations and social structures among their colleagues in determining fraud risk assessment. Since the whole members in the team bear the risk, auditors with more collectivist culture are likely to be less critical in the assessment and have lower perception of fraud risk.

(c) The Relationship of Power Distance

Hypothesis 3 examines the relationship of power distance towards fraud risk assessment. The result shows negatively significant the relationship between power distance and fraud risk assessment ($B = -0.147, p < 0.1$), thus hypothesis 3 is accepted. Therefore, high power distance culture in audit firms which is related to the high staff loyalty level, obeying instruction with less critical argument and more autocratic style of management, in general does lead to lower fraud risk assessment.

5.0 CONCLUSION AND LIMITATION

In conclusion, the results indicated that 3 hypotheses were supported, i.e hypotheses 1, hypotheses 2 and hypotheses 3. The multiple regression result appears to suggest that in-group collectivism and power distance cultural dimension negatively influence fraud risk assessment among auditors. This result implies that in-group collectivism and power distance could hamper the objectivity of auditors to do the audit with adequate level of professional in assessing fraud risk. The application of cultural dimension in fraud risk assessment is also found to be varying in different organizations. The result also appears to suggest that auditors’ experience positively influence fraud risk assessment among auditors.

This study may have some limitations. Firstly, the relationships of these cultural dimensions are examined on the basis of individual auditors. In the real situation, the audit work is commonly performed by audit teams. Thus, it would be more appropriate to assess the exercise of professional judgment among audit teams. In addition, the use of a Likert scale in this study to measure these two cultural dimensions may not be appropriate because of elements of subjectivity in the construct. In the future, an experimental design may be a better approach to study the relationships of cultural dimensions among auditors or audit teams.
### 6. PAKISTAN

**List of Acronyms**

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Full Form</th>
</tr>
</thead>
<tbody>
<tr>
<td>AGP</td>
<td>Auditor General of Pakistan</td>
</tr>
<tr>
<td>BOO</td>
<td>Build Own Transfer</td>
</tr>
<tr>
<td>BOT</td>
<td>Built Operate Transfer</td>
</tr>
<tr>
<td>BT</td>
<td>Built Transfer</td>
</tr>
<tr>
<td>DAGP</td>
<td>Department of the Auditor General of Pakistan</td>
</tr>
<tr>
<td>DG</td>
<td>Director General</td>
</tr>
<tr>
<td>FAO</td>
<td>Field Audit Office</td>
</tr>
<tr>
<td>ECC</td>
<td>Economic Coordination Council</td>
</tr>
<tr>
<td>GoS</td>
<td>Government of Sindh</td>
</tr>
<tr>
<td>KPI</td>
<td>Key Performance Indicators</td>
</tr>
<tr>
<td>NA</td>
<td>National Assembly</td>
</tr>
<tr>
<td>NHA</td>
<td>National Highway Authority</td>
</tr>
<tr>
<td>NHSP</td>
<td>National Health Service Package</td>
</tr>
<tr>
<td>O&amp;M</td>
<td>Operations &amp; Maintenance</td>
</tr>
<tr>
<td>PA</td>
<td>Provincial Assembly</td>
</tr>
<tr>
<td>PAC</td>
<td>Public Accounts Committee</td>
</tr>
<tr>
<td>PPP</td>
<td>Public Private Partnership</td>
</tr>
<tr>
<td>PPPF</td>
<td>Public Private Partnership Fund</td>
</tr>
<tr>
<td>PR</td>
<td>Pakistan Railways</td>
</tr>
<tr>
<td>PSDP</td>
<td>Public Sector Development Program</td>
</tr>
<tr>
<td>PVICS</td>
<td>Punjab Vehicle Inspection and Certification System</td>
</tr>
<tr>
<td>SAI</td>
<td>Supreme Audit Institution</td>
</tr>
<tr>
<td>SEF</td>
<td>Sindh Education Foundation</td>
</tr>
<tr>
<td>RFP</td>
<td>Request for Proposal</td>
</tr>
<tr>
<td>SPV</td>
<td>Special Purpose Vehicle</td>
</tr>
<tr>
<td>TOR</td>
<td>Terms of Reference</td>
</tr>
<tr>
<td>VGF</td>
<td>Viability Gap Fund</td>
</tr>
</tbody>
</table>
1. INTRODUCTION

According to the country’s Constitution, Pakistan is a Federal Republic to be known as the Islamic Republic of Pakistan (hereinafter referred to as Pakistan). The territories of Pakistan comprise of the Provinces of Balochistan, the Khyber Pakthunkhwa, the Punjab and Sindh. The territories also include the Islamabad Capital Territory, Federally Administered Tribal Areas, Gilgit Baltistan and such States and territories as are or may be included in Pakistan, whether by accession or otherwise.

1.2 The Constitution defines "the State" as the Federal Government, the Parliament, a Provincial Government, a Provincial Assembly, and such local or other authorities in Pakistan as are by law empowered to impose any tax or cess. The President of Pakistan is the Head of State, representing the unity of the Republic. The Parliament makes laws for the whole or any part of Pakistan, and a Provincial Assembly makes laws for the Province or any part thereof. The Parliament has exclusive power to make laws with respect to any matter in the Federal Legislative List while a Provincial Assembly has the power to make laws with respect to any matter not enumerated in the Federal Legislative List. At the same time, both the Parliament and a Provincial Assembly have the power to make laws with respect to criminal law, criminal procedure and evidence. Furthermore, if any provision of an Act of a Provincial Assembly is repugnant to any provision of an Act of the Parliament which the Parliament is competent to enact, then the Act of the Parliament, whether passed before or after the Act of the Provincial Assembly, shall prevail and the Act of the Provincial Assembly shall, to the extent of the repugnancy, be void.

1.3 The Parliament consists of the President and two houses known as the National Assembly and the Senate. A Bill relating to any matter in the Federal Legislative List may originate in either House. If the Bill is passed by the House in which it originated, it is transmitted to the other House for consideration. If the Bill is passed without amendment by the other House also, it is presented to the President for assent. A Money Bill, including the Finance Bill containing Annual Budget Statement, can only originate in the National Assembly. When a Money Bill is presented in the National Assembly, a copy thereof is transmitted to the Senate, which may within fourteen days make recommendations thereon to the National Assembly. The Money Bill when passed by the National Assembly, with or without incorporating the recommendations of the Senate, is presented to the President for assent.

1.4 According to Article 140 A of the Constitution, each Province is required to establish a local government system by law, and devolve political, administrative and financial responsibility and authority to the elected representatives of the local governments. In pursuance of the constitutional requirement, each of the four Provinces has established a local government system by promulgating Local Government Act through their respective Provincial Assemblies.

1.5 The executive authority of the Federation is exercised in the name of the President by the Federal Government. The Federal Government consists of the Prime Minister and the Federal Ministers. The Cabinet of Ministers, headed by the Prime Minister, aids and advises the President in the exercise of his functions. The Prime Minister is the chief executive of Federation, elected by the majority of the total membership of the National Assembly. The Federal Ministers are appointed by the President on the advice of the Prime Minister from amongst the members of the Parliament.
1.6 At the Provincial level, a Governor is appointed by the President in each Province. The executive authority of the Province is exercised in the name of the Governor by the Provincial Government. The Provincial Government consists of the Chief Minister and the Provincial Ministers. The Provincial Cabinet, headed by the Chief Minister, aids and advises the Governor in the performance of his functions. The Chief Minister is elected by the majority of the votes of the Provincial Assembly while the Provincial Ministers are appointed by the Governor, on the advice of the Chief Minister, from amongst the members of the Provincial Assembly.

1.7 The set-up of Local Government System in the four Provinces varies according to the requirements of their respective Local Government Acts.

PPP Legal Framework - Federal Government Level

1.8 To establish a regulatory framework for execution of PPP projects in Pakistan, “the Public Private Partnership Authority Act, 2017” was enacted by the Parliament on 27th March 2017. The legislation extends to the whole of Pakistan and applies to all kinds of projects undertaken by an implementing agency (line ministries, attached departments, body corporate, autonomous body of the Federal Government or any organization or corporation owned or controlled by the Federal Government) under PPP arrangement.

1.9 The Act defines a "public private partnership" as a commercial transaction between an implementing agency and a private party (a person eligible to bid for a public private partnership project with the implementing agency). The private party, as per the transaction, performs an implementing agency's functions on behalf of the agency, uses public property for a project, and assumes substantial financial, technical and operational risks in connection with performance of the implementing agency's functions or use of the public property. In return, the private party receives:

   a. consideration to be paid by the implementing agency from its budget or revenue; or

   b. charges or fees (to be collected by the private party from users or customers of a service provided to them); or

   c. a combination of such consideration and such charges or fees.

Institutional Arrangements

1.10 As per the Act, the Federal Government is required to establish a Public Private Partnership Authority after commencement of the Act. The Authority so established would be an independent body corporate having perpetual succession and common seal. The Authority would be responsible to:

   a. ensure that projects are consistent with national and sectoral strategies;

   b. ensure value for money by conducting an analysis to evaluate projects;

   c. adhere to the principle of budget affordability in the context of medium term budgetary framework;

   d. make assessment of fiscal risk;
e. advise and facilitate the implementing agency to identify, develop, structure and procure the projects;
f. prescribe and receive fee and charges;
g. standardize the contractual provisions and to develop the sector specific provisions of the model PPP agreements;
h. develop annuity, user-based and hybrid financial models for the projects;
i. ensure that PPP agreement is consistent with the provisions of this Act;
j. interact, collaborate and liaise with international agencies;
k. play the role of gatekeeper at all stages of project cycle such as planning, tendering, bidding and contract; and
l. notify, from time to time, a limit on the size of PPP projects that an implementing agency may undertake in relation to its annual spending.

1.11 To carry out the functions of the Authority there would be a Board of Directors, comprising of seven members. The Chairperson of the Board would be the Federal Minister of Finance, Revenue and Economic Affairs. The other members would be Secretary, Finance Division (Vice-Chairperson), Secretary, Planning and Development Division, Secretary Board of Investment, Chief Executive Officer of the Authority and two members from private sector to be nominated by the Federal Government. The general directions and superintendence of the Authority and its affairs would be vested in the Board which may exercise all powers, perform all functions and do all acts which may be exercised, performed or done by the Authority.

**Funds, Accounts and Audit**

1.12 The Act establishes the PPP Fund to meet the expenditure of the Authority in performance of its functions. The sources of funding include sums and grants from the Federal Government, donations and grants from the international donor agencies, income from investments, fees and any other sources approved by the Federal Government. The Act also establishes a “Viability Gap Fund (VGF)” for financial support of the projects which are considered socially and economically feasible but are not financially viable.

1.13 The Accounts of the Authority are required to be kept in such forms as may be required by the Board and consistent with the requirement of the applicable laws. A chartered accountant firm, appointed by the Board, would conduct audit of the Authority. However, the Auditor General of Pakistan may also conduct audit of the accounts of the Authority.

1.14 The responsibilities of an implementing agency with respect to the planning, development, procurement, implementation, execution and monitoring of a project include the following:

a. identify, conceptualize, appraise and develop the project;

b. undertake or cause to be undertaken a feasibility study;
c. develop and issue or cause to be developed and issued a request for proposal including draft of the PPP agreement;
d. procure a project only through a competitive bidding process as prescribed;
e. monitor and implement the project in accordance with the PPP agreement.
f. submit the bid documents and the project proposal for approval of the Board; and
g. procure the project as per requirement of the Act, after project proposal has been approved by the Board.

**Project Procurement Process**

1.15 The Act does not specify in detail the project procurement process. However, as evident from above, while outlining the responsibilities of an implementing agency, the Bill requires the agency to procure a project only through a competitive bidding process. Furthermore, it requires the agency to develop and issue a “request for proposal”. And, according to the definitions of terms used in the Act, “RFP” means the publicly advertised tender inviting proposals for a project prepared in accordance with the provisions of the Act. The implementing agency, after the project proposal has been approved by the Board, is required to invite the successful private party bidder for finalization of the PPP agreement.

1.16 Exception to competitive bidding, that is, negotiated procurement of a PPP project, is allowed only where the project is being undertaken on the basis of any Federal Government’s bilateral treaty or arrangement or where the Federal Government authorizes such an exception for reasons to be recorded in writing, in the public interest.

**Contents of Agreement**

1.17 Regarding PPP agreements, the legislation requires the implementing agency to observe the laws applicable to them with respect to the following issues:

a. the scope of activities of the parties to the agreement;
b. the duration of the agreement;
c. the payment arrangements for the private party, including where applicable, the factors based on which and the manner in which user charges or tariffs may be revised;
d. the rights and obligations of the parties and the respective risks to be borne by each party;
e. the penalties for non-compliance with the provisions of the PPP agreement;
f. dispute resolution mechanisms;
g. exit clauses specifying procedure of early termination of the PPP agreement;
h. termination payments and compensations, if agreed and provided in the PPP agreement;

i. the debt-equity ratio;

j. the monitoring;

k. project insurances and treatment of insurance proceeds;

l. operation and maintenance requirements; and

m. reversion, transfer or handing back of the project, wherever applicable and all the associated assets to the implementing agency upon expiry or termination of the PPP agreement.

In order to implement the project, the private party is required, with or without the participation of the implementing agency, to incorporate a company as SPV to undertake the project.

1.18 An implementing agency, subject to the decision of the Board, is allowed to enter into any contractual relationship with a private party, provided that such a relationship is capable of providing value for money and affordability for the implementing agency and the users of the project. Furthermore, an implementing agency is empowered to:

a. transfer an interest, or part of an interest, of its present or future assets in the project to the private party. However, in case of immovable assets, the title to the asset cannot be transferred to the private party;

b. transfer the right to receive directly revenues or receivables of the project to the private party during the currency of the PPP agreement;

c. permit the private party to create security interests over or in respect of the present or future assets created by it, revenues, or receivables, comprised in or expected, in connection with the Project in favour of any lender providing loans for the project;

d. enter into agreements with lenders to the project; and

e. agree to pay compensation for early termination of the PPP agreement in the manner stated in the contract.

1.19 In the event of any disputes, neither the implementing agency nor the private party is permitted to initiate any judicial or quasi-judicial proceedings until such time that the remedies available in the public private partnership agreement have been fully exhausted. The private party, its agents, its contractor or sub-contractors are also not permitted to stop, impede, suspend, either in whole or in part, or cause the suspension of or delay the provision of, the services to the users on account any dispute under the PPP agreement.

1.20 According to the Act, all rights associated with the project along with all the movable and immovable properties, project’s physical assets, licenses, goodwill, trademarks, patents, leases including intellectual property rights and interests would vest in
the private party during the tenure of the PPP agreement. After expiry of the PPP agreement, all the aforesaid properties would stand transferred, without any lien, charge or encumbrance, to the implementing agency in accordance with the provisions of the PPP agreement. The legislation places following restrictions on the private party with respect to the project:

a. the private party would not create any lien, charge or encumbrance, in favour of the lenders, over the immovable properties of the implementing agency as collateral, except with the prior approval of the Board;

b. the private party shall not assign, transfer, sublet or part with its possession either in whole or in part, the project or its related services to any of the third parties, except to the extent provided for in the PPP agreement; and

1.21 The Federal Government or the implementing agency would not be held liable for any claim of the private party for a risk which is not specified in the PPP arrangement. Also, the Federal Government or the implementing agency may recover a sum due from a private party as arrears of land revenue under the provisions of the West Pakistan Land Revenue Act, 1967.

1.22 As we can see from the salient features of the Act described above, a comprehensive set of provisions have been enacted to regulate PPP arrangements. However, we find no provision relating to audit of PPP projects by the AGP office. Absence of such a provision may prove to be a serious hurdle in ensuring accountability over use of public resources in PPP projects. This issue will be dealt in greater detail when we discuss the audit mandate of AGP in respect of PPP projects.

Legal Framework at the Provincial Level

1.23 At present, three Provinces have passed laws governing the PPPs arrangements within their provincial jurisdictions, as follows


By and large, the provincial Acts have similar provisions as the federal legislation but the provincial Acts in some areas specify certain additional and/or different requirements. The additional requirements or differences are briefly described in the following paragraphs.

Organizational Framework

1.24 Under the Acts, the respective Provincial Governments are required to establish an organizational framework for the purpose of executing PPP projects as follows:

<table>
<thead>
<tr>
<th>Punjab</th>
<th>Sindh</th>
<th>Khyber Pakhtunkhwa</th>
</tr>
</thead>
<tbody>
<tr>
<td>Steering Committee: Provincial Minister for Planning &amp; Development</td>
<td>PPP Policy Board : Chief Minister of Sindh</td>
<td>PPP Committee: Provincial Minister for</td>
</tr>
</tbody>
</table>

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<table>
<thead>
<tr>
<th>Chairman and Provincial Finance Minister Vice Chairman</th>
<th>Chairman and Provincial Minister for Planning and Development Vice Chairman</th>
<th>Planning &amp; Development Chairman and Provincial Finance Minister Vice Chairman</th>
</tr>
</thead>
<tbody>
<tr>
<td>PPP Cell, established in Planning &amp; Development Department</td>
<td>PPP Unit, established in Finance Department</td>
<td>PPP Unit, established in Planning &amp; Development Department</td>
</tr>
<tr>
<td>Risk Management Unit established in Finance Department</td>
<td>PPP Node to be established within each Implementing Agency which intends to undertake PPP Project</td>
<td>PPP Node to be established within each Implementing Agency which intends to undertake PPP Project</td>
</tr>
<tr>
<td>PPP Node to be established within each Implementing Agency which intends to undertake PPP Project</td>
<td>Project Implementation Unit for each PPP project within each Implementing Agency</td>
<td></td>
</tr>
</tbody>
</table>

The PPP Cell / Unit acts as Secretariat of, and assist the Steering Committee/Policy Board/Committee in formulating policies, developing operating guidelines and human resources, evaluating and prioritizing project proposals submitted by implementing agencies, reviewing the bid evaluation report of implementing agencies, overseeing project implementation etc.

1.25 According to the provincial Acts, an implementing agency for a PPP project could be a department, attached department, body corporate, autonomous body of the Government, local government, or any organization or corporation owned or controlled by the Government or local government.

1.26 An implementing agency, intending to undertake a PPP project, is required to establish a PPP node which would be responsible for:

a. identifying suitable projects and prioritizing these within its sector or geographical area of responsibility;

b. preparing pre-feasibility study and feasibility study for approval of the Policy Board / Committee through the Unit / Cell;

c. submitting project proposal through the Unit / Cell to the Policy Board / Committee;

d. conducting competitive tendering process, evaluating bids and signing partnership agreement; and

e. monitoring and evaluating implementation and operation of the project.

1.27 In addition to the above, the Sindh Act specifies formation of a Project Implementation Unit, within an implementing agency, to oversee day to day implementation of a project and the Punjab Act requires establishment of a Risk Management Unit to act as fiscal guardian for the projects. The Risk Management Unit, among other things, is responsible for:
a. developing risk management guidelines for approval by the Committee

b. examining, in consultation with the Cell, whether requests for Government support and proposed risk sharing arrangements are consistent with the Act;

c. recommending the inclusion of approved Government support in the annual budget of the Province; and

d. monitoring direct and contingent liabilities of the Government incurred through the projects.

**Procurement Process**

1.28 The three provincial Acts call for selection of a private party through a process of pre-qualification and competitive bidding. The Sindh and the Khyber Pakhtunkhwa Acts also state that the provincial public procurement rules would apply to the procurement process. The Punjab and the Khyber Pakhtunkhwa Acts spells out in detail the bidding process and the bid evaluation criteria. The Khyber Pakhtunkhwa Act, in addition, describes the circumstances in which contract can be awarded to a private party without following competitive procedures.

**Accounting, Reporting and Audit**

1.29 According to each of the three provincial Acts, it would be within the purview of the respective Provincial Government to establish / issue a uniform system of accounts / accounting guidelines, to be followed by the private party. The implementing Agency is responsible for inclusion of appropriate reporting and audit requirements in the PPP Agreement, taking into consideration the nature of the project, its business structure, the source of financing and the financial commitments of the Government to the private party. The implementing agency is permitted to retain outside consultants and auditors to perform periodic reviews of the private party’s accounts.

**Legal Framework at the Regional / Public Sector Organizational Level**

1.30 The Federal Public Private Partnership Act, 2017 also applies to an implementing agency, which may be any organization or corporation owned or controlled by the Federal Government. Similarly, the provincial Acts apply to organizations or corporations owned or controlled by the respective Provincial Governments. The provincial Acts are also applicable on the implementing agencies belonging to the Local Governments of the respective Provinces.

**2. PPP ARRANGEMENTS AND SECTORAL FOCI**

At present, concentration of PPP projects is in the physical infrastructure of the country, particularly transport sector. The majority of PPP projects in Pakistan so far have been undertaken in this sector under BOT modality and a few under BT modality. Besides, in social infrastructure sectors like health and education government facilities have been handed over to private partners as O & M contracts, service contracts or other variants of
PPP modalities. O&M contracts have also been entered into by PR for rail transportation. In the following paragraphs, we will discuss these modalities as understood or defined in Pakistan and some of the PPP projects undertaken by Federal, Provincial and Local Governments.

**Build Operate Transfer**

2.1 In the Build Operate Transfer (BOT) modal, as used in Pakistan, “Build” means that private partner (a company or consortium) agrees with a government to invest in a infrastructure project: “Operate” means that the private partner then owns, maintains and manages the facility for an agreed concession period and recover the investment through charges or tolls. Transfer means that at the end of the concession the project facility is transferred to the public partner.

2.2 The National Highway Authority (NHA) at the federal level and the Works & Services / Transport Department at provincial level has used the BOT modality for launching PPP projects. Currently, seven projects of NHA are at the implementation stage. These projects include construction of tunnel, motorways, railway overhead bridge and development of service areas along motorways / highways. The concession period under these projects ranges from 15 years to 30 years.

2.3 The Government of Sindh has executed the Hyderabad Mirpurkhas Dual Carriageway Project with a Korean firm namely M/S Deokjae Construction Company. The concession agreement was signed on November 11, 2009 for a period of 32 years (2 years construction and 30 years Operation and Maintenance). The project road is 60 km long with 8 bridges and 62 culverts. The other roads / bridges projects which are in construction phase are Jhirk Mulla Katiyar Bridge Project over River Indus and the Karachi Thatta Dual Carriageway Project.

2.4 The Government of Punjab has executed “Flyover over Railway Crossing Kahna Kachha, Lahore”. The agreement with the private partner was signed in January 2015, with a concession period of 25 years. The provincial Government has also completed the “Punjab Vehicle Inspection and Certification System (VICS) Project” in June 2016 under BOT modality. Besides, BOT contract has been awarded in respect of Dualization of Sheikhupura-Gujranwala Road Project.

**Build Transfer**

2.5 Under “Build Transfer” arrangement, the private partner provides finances for the project / infrastructure and builds the infrastructure. Upon completion of construction the project assets / infrastructure are transferred to the public partner. The public partner makes fixed or partially fixed periodic payments (annuities) to the private partner, according to an agreed schedule. The payments cover the total cost of the project and markup. The “Lahore Ring Road (Southern Loop) Project” of the Government of Punjab has been awarded on BT basis.

Under a variant of BT modality, the Government of Punjab has awarded a PPP project “Affordable Housing Apartments at Ashiana-e-Iqbal, Lahore” to a private partner. The private partner is required to finance, design, construct and develop a committed number of apartments, residential plots, commercial plots etc., at the site and transfer these to the public partner on BT basis against a consideration of residential commercial and
public building plots in the project. The public partner is required to make an estimated 3,100 kanals of land available for the project.

**Service Contracts / Operation & Maintenance Contracts**

2.6 In Service Contracts some services are out sourced to a private partner to be provided to the public partner / users. The general control and supervision remain with the public partner. O&M Contracts give a wider role to the private partner by outsourcing management and operation of public infrastructure to a private partner. Under both types of contracts there is limited or no funds provided by the private partner. O&M Contracts have often been made part of BOT arrangements.

2.7 Pakistan Railways (PR) is a state-owned enterprise, providing rail transportation service throughout the country. PR handed over the management of four trains, namely Shalimar Express, Business Express, Hazara Express and a night coach to private partners. The locomotives, coaches, dining cars, operational staff and fuel were provided by PR. The contracts were for three years period, extendable to five years. The private partners collects the revenues earned from operations of the trains and was required to remit an agreed fixed amount to PR on daily basis.

2.8 The Primary and Secondary Healthcare Department, Government of Punjab is in the process of awarding management contracts (O&M) in respect of health facilities in five districts of the province. The responsibilities of private partner include maintenance of infrastructure, procurement and provision of medical and non-medical supplies and consumables, enforcement of clinical and hygienic protocols, employing efficient administrative practices that ensure patient satisfaction etc. The public partner will be required, among other things, to provide funds as agreed in the contract provide information on the status of facilities, guide on quality regimes, co-ordinate with district officials, monitor and award penalties in case of non-performance of private party. The Health Department, Government of Sindh, on similar lines, has already contracted out Government health facilities in seven districts and one town in March 2015. The Government awarded the performance based management and services contracts to the nationally and internationally accredited organizations for a term of 10 years.

2.9 In the education sector, various initiatives have been taken, employing PPP arrangement, to increase access to education and to improve the quality of education services provided to the children in remote and marginalized areas. The Sindh Education Foundation (SEF), a semi-autonomous organization, under SEF Assisted School Program partners with reputable private educational institutions to open quality Primary, Elementary, and Secondary Schools in different districts of Sindh province. Selected private partners receive a fixed amount of subsidy per child per month. The private partners are required to ensure a minimum enrolment of students at the time of opening schools with an assurance to increase the enrolment to optimum levels in subsequent years. It is mandatory for the selected partners to recruit qualified teachers and pay them market competitive salaries as per minimum wage announced by the Government. Each school must have necessary infrastructure. Payment of subsidies is linked to Annual Student Assessments. In cases where a school does not meet the minimum standards of educational attainments, SEF reserves the rights to terminate the contract after adequate warnings under the contract. Similar programs in the education sector have been launched in the provinces of the Punjab and Khyber Pakhtunkhwa by the respective Provincial Governments.
2.10 At the local government level, PPP arrangements have mostly been used for execution of different municipal functions, like solid waste management, in the Punjab. Besides, cattle market management companies have been established under PPP arrangement. The cattle market management companies are tasked with establishing, operating and regulating cattle markets in a few cities in the Punjab.

**Linkage with Socio-Economic Priorities**

2.11 The Economic Coordination Committee (ECC) of the Federal Cabinet of Pakistan approved a “Policy on Public Private Partnerships” in January, 2010. The sectors covered in the Policy for undertaking PPP projects are as follows:

i) Transport and logistics including federal, provincial and municipal roads, rail, seaports, airports, fishing harbors as well as warehousing, wholesale markets, slaughter houses and cold storages.

ii) Urban Public Transport including integrated bus systems as well as intra and inter-city rail systems.

iii) Local Government Services including water supply and sanitation; solid waste management; low cost housing, and healthcare/education and skills development facilities.

iv) Energy Projects including hydroelectric and captive power generation projects.

v) Tourism projects including cultural centers, entertainment and recreational facilities and other tourism related infrastructure.

vi) Industrial projects including industrial parks, special economic zones and related projects.

vii) Irrigation projects some of these combined with power generation.

viii) Social infrastructure which includes education, culture, and health infrastructure.

2.12 At present, 11th Five Year Plan (2013-18) is being implemented. The Plan identifies public private partnership as a key area in the context of putting the national economy on the path of long-term economic growth. While describing its overall objectives and strategy, the Plan states that given the resource constraints and importance of the private sector as an engine of economic growth, “the government through public sector investment will also provide an enabling environment to crowding in the private sector and fostering PPP and JVs to reduce the burden on the PSDP.” The projected outcomes of the Plan include enhancing delivery, cost effectiveness and quality of output of the public sector investment program through adoption of PPPs.

2.13 The Plan identifies following sectors for execution of development projects under PPP arrangement:

ix) Transport and Logistics: Construction of motorways and bridges; development of transport logistic facilities comprising pack houses, cold storage facilities, reefer containers and reefer yards;

x) Physical Planning & Housing: Development of new urban centres and housing projects on the Build Own Operate and Build Operate Transfer (BOO and BOT) basis;
xi) Agricultural development: Improving post-harvest management and marketing infrastructure including setting up livestock markets and state-of-the-art slaughterhouses;

xii) Primary & Secondary Education: To improve access to educational facilities by providing incentives for accommodating poor children in quality private schools in the form of public financing (e.g. per child subsidy) as a part of PPP; and

xiii) Health: Introduction of a comprehensive National Health Service Package (NHSP) in the form of PPP to address new initiatives, such as vaccine production, social health protection and health insurance including patient safety and school health services

2.14 It can be observed that the PPP projects have been undertaken in the sectors specified in the Pakistan Policy on Public Private Partnerships, 2010. Most of the projects completed or under implementation are in the transport sector. These projects include constructions of motorways, highways and bridges launched by the NHA, Punjab and Sindh Governments under BOT modality. Pakistan Railways, on the other hand, has outsourced operation of its certain trains to private partners. In Health sector, provincial governments of Sindh and Punjab have handed over management of its healthcare facilities in a few districts to private partners. In education sector also, Punjab and Sindh have launched schemes under PPP arrangement. However, there are still sectors like Industry, irrigation, tourism, in which no significant progress has been made as yet.

2.15 The selection of PPP modality for a project is initially made by the implementing agency while submitting project proposals to the concerned PPP Unit/Cell of the Federal Government or the respective Provincial Government. According to the PPP Act, 2016 of the Federal Government, an “implementing agency and private party may enter into any contractual relationship that is capable of providing value for money and affordability for the implementing agency and the users of the project.” The Provincial Acts also have similar provision regarding selection of type of modality.

2.16 A key motivation for Federal and Provincial Governments in Pakistan to procure and deliver infrastructure projects through PPP arrangement is that it is more likely to deliver higher value for money than traditional delivery arrangements. As pointed out earlier, the 11th Five Years Plan seeks to enhance delivery, cost-effectiveness and quality of public sector investment program through adoption of PPP model for development projects. Then, the fiscal constraints faced by the Governments and, at the same time, substantial investment required in infrastructure in Pakistan, have compelled the planners to look for innovative approaches to infrastructure provisioning and funding.

2.17 As we have seen, there are different modalities available for establishing partnership between public and private sector. These modalities differ primarily in three respects which are: the allocation of risks between public and private partners, the investment by public and private partners and the control and ownership of assets. The selection of a modality for a project, on the part of the public partner, depends largely on the above three elements. In Pakistan most of the transport infrastructure PPP projects have been awarded to private partners on BOT basis. This modality has enabled the
government to tackle the problem of substantial gap between funds required for infrastructure development and funds available with the government. The partnership with private sector also allows the government to have access to new technologies, skills, expertise. Then, the risks associated with infrastructure projects, such as design risks, construction risks, commercial risks etc., have largely been transferred to the private partner. In return, however, the private partner requires adequate compensation which is arranged in the form of a concession agreement. As the concession period usually spreads over 20 to 30 years, uncertainties relating to general political climate in the country, law and order situation, changes in government policies etc., have a strong bearing on the terms of the concession agreements.

2.18 In case of social infrastructure projects / schemes, the governments have mostly entered into operation & maintenance contracts. Government owned education and health facilities have been handed over to private partners through such contracts. These facilities continue to get budget from the government and they retain the government employed operational staff, teachers, doctors etc. The private partners are required to perform against an agreed set of Key Performance Indicators. One of the main reasons for selection of O&M modality in Pakistan is that public sector infrastructure, that exists currently, is in poor shape, largely owing to inefficient management and unethical practices prevalent in the sector. In order to improve the quality and delivery of healthcare and educational services, the strategy adopted is effective management of available resources. Under O&M contracts, the government gets access to private sector’s managerial efficiencies rather than investment. The risks remain with the public partner except the risks associated with delivery of services and maintenance of facilities according to the agreed standards.

3. STAGE-WISE RISKS IN PPP PROJECTS

In the previous section, we have seen that PPP arrangements in Pakistan have most commonly been used in the transport sector. We have also seen that, by and large, the BOT modality has been used in the transport sector. Therefore, here attempt will be made to ascertain the general risk situations with respect to the BOT modality. Furthermore, the Federal and Provincial PPP Acts have spelled out the responsibilities of an implementing agency and PPP Unit / Cell and in the PPP process, from conceptualization of a PPP project till its completion. We, from the standpoint of an auditor, consider it to be appropriate to view the general risk situations against the backdrop of these responsibilities, as the same are embedded in the applicable legislation.

3.2 The responsibilities of the public partner authorities, in general, based on the provisions of the Federal and Provincial Acts, are summarized in the following table:

<table>
<thead>
<tr>
<th>Stage</th>
<th>Responsibility</th>
<th>Agency / Node</th>
<th>PPP Unit / Cell</th>
</tr>
</thead>
<tbody>
<tr>
<td>○</td>
<td>Identify suitable projects</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Procurement</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>---</td>
<td>---</td>
<td>---</td>
<td></td>
</tr>
<tr>
<td>Prioritize projects within its sector or geographical area</td>
<td>✓</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Recruit transaction advisers and supervise preparation of feasibility study</td>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Prepare project proposals</td>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Submit proposal for approval through PPP Unit/ Cell to the Authority / Committee/ Board</td>
<td>✓</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Conduct competitive tendering consisting of prequalification and bidding to select private partner</td>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Conduct bid evaluation and submit recommendation for award of contract through PPP Unit / Cell to the Authority / Committee/Board</td>
<td>✓</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Negotiate agreement with private partner and sign agreement with the private partner</td>
<td>✓</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Monitoring &amp; Implementation</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Monitor &amp; Implement the project in accordance with the terms of the agreement</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Submit periodic reports on the performance of the project(based on reports submitted by the private party ) to the PPP Unit / Cell to the Authority / Committee</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>

3.3 The table No 02 gives an indicative list of potential risk areas corresponding to the different stages of PPP project cycle along with the responsibilities of the concerned public partner:

**Table No: 02 Stages of PPP Project & Potential Risk Areas**

<table>
<thead>
<tr>
<th>S #</th>
<th>Responsibilities Requirements</th>
<th>Potential Risk Areas (an indicative list)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Identifying suitable projects and prioritizing them within implementing agency’s sector or geographical area</td>
<td>a. The PPP Unit / Cell and / or PPP nodes may not be properly staffed, role and responsibilities of staff not clearly defined and staff not appropriately skilled to provide specialized guidance and direction; b. The implementing agency may not have formed adequately staffed PPP nodes, equipped with requisite skills to conceive / identify /propose PPP projects;</td>
</tr>
</tbody>
</table>
2. Recruiting transaction advisor(s) for project preparation and tendering

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>a.</td>
<td>The persons / consultants who bid for selection as advisors may not have been made aware of what was expected from them and what would be the deliverables;</td>
</tr>
<tr>
<td>b.</td>
<td>The advisor(s) selected may not possess experience and expertise in areas concerned such as:</td>
</tr>
<tr>
<td></td>
<td>i. Public &amp; Administrative Law matters and issues relating to business and taxation;</td>
</tr>
<tr>
<td></td>
<td>ii. Finance and Accounting;</td>
</tr>
<tr>
<td></td>
<td>iii. Technical &amp; Engineering matters specialized by sectors;</td>
</tr>
<tr>
<td>c.</td>
<td>Selection of advisor(s) may not have been done in a transparent manner; and</td>
</tr>
<tr>
<td>d.</td>
<td>Advisor(s) may have conflicts of interest with respect to the project.</td>
</tr>
</tbody>
</table>

3. Preparing feasibility study and project proposal

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>a.</td>
<td>Feasibility study analysis may not have been done thoroughly in respect of:</td>
</tr>
<tr>
<td></td>
<td>i. PPP modality, technical suitability and financial viability;</td>
</tr>
<tr>
<td></td>
<td>ii. Ability and willingness of Customers to Pay (Affordability);</td>
</tr>
<tr>
<td></td>
<td>iii. Environmental and Social Impact of the Project;</td>
</tr>
<tr>
<td></td>
<td>iv. Need for and availability of Government support;</td>
</tr>
<tr>
<td></td>
<td>v. Availability of key inputs;</td>
</tr>
<tr>
<td></td>
<td>vi. Comparison with other Project Candidates;</td>
</tr>
<tr>
<td></td>
<td>vii. Commercial Risks:</td>
</tr>
<tr>
<td></td>
<td>o Construction risks (design issues, site / land acquisition issues, cost overrun, time overrun</td>
</tr>
</tbody>
</table>
etc.;

- Operational risks (changes in interest rates, inflation, changes in technology over project's life);

- Demand Risks (user volume being less than the expected or assumed level);

viii. Legal Risks (changes in applicable legal/regulatory framework, issues in obtaining permit/approvals from government agencies);

ix. Political Risks: (changes in government policies such as taxation, nationalization etc., changes in public opinion about the risks);

b. Feasibility study may have been prepared without consulting all stakeholders; and

c. Project proposals may not be in line with the feasibility study.

| Procurement | Conducting competitive tendering | 12. Criteria for pre-qualification of bidders may not have been laid in accordance with the guidelines of the PPP Unit/Cell or Policy Board/Committee;

13. Invitation to participate in pre-qualification may not have been advertised as per requirements of applicable rules;

14. Instructions to bidders may not have clearly specified the information required from the prospective participants regarding their legal, technical, managerial and financial capacity to undertake the project;

15. Potential bidders may not have been clearly communicated the expectations/requirements of implementing agency from the project so as to develop their bids accordingly;

16. Bidding documents for inviting bids from the pre-qualified parties may not have been prepared in accordance with applicable rules.

17. Pre bid meeting with pre-qualified parties may not be held, within reasonable period of time, to provide clarifications to the parties and to discuss terms and conditions of the agreement.

| 5 Conducting bid | a. Technical Proposals may not have been properly |
evaluation evaluated on the basis of technical soundness, 
compliance with environmental standards, operational 
feasibility; and quality of services and measures to 
ensure their continuity.

b. Commercial / Financial Proposals may not have been 
properly compared on the basis of , at least, the 
following:

i. the present value of the proposed tariff, tolls, 
unit prices;

ii. the present value of the proposed direct 
payments by the Government , if any;

iii. the costs of design and construction activities, 
annual operation and maintenance costs; 
present value of capital costs and operating and 
maintenance costs;

iv. the soundness of proposed financial 
arrangements; and

v. the extent of acceptance of negotiable 
contractual terms proposed by the 
Implementing Agency in the bidding documents.

6 Negotiate 
agreement with 
private partner 
and sign 
agreement

a. The negotiated agreement may be lacking / deficient in 
respect of one or more of the essential provisions , for 
example:

i. scope of work and services to be provided under the 
project;

ii. main technical specifications, performance standards, 
environmental and safety requirements;

iii. implementation milestones and completion date of the 
project;

iv. cost recovery scheme through user levies / fees;

v. performance bonds for construction works and 
operations;

vi. acceptance test and procedures;

vii. rights and obligations of the parties to the agreement, 
including risk sharing;
### 3.4

The above matrix provides an indicative list of the potential risk areas corresponding to different stages of a PPP project and responsibilities of the public partner. Auditors will have to carry out a detailed review, on case to case basis, of each PPP project in order to identify the potential risk areas of the PPP project.

<table>
<thead>
<tr>
<th>Column</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>viii.</td>
<td>penalties and liquidated damages provisions;</td>
</tr>
<tr>
<td>ix.</td>
<td>handback requirements at the end of the agreement;</td>
</tr>
<tr>
<td>x.</td>
<td>requirements and procedures for variations of the agreement;</td>
</tr>
<tr>
<td>xi.</td>
<td>grounds for and effects of termination of the agreement including <em>force majeure</em>;</td>
</tr>
<tr>
<td>xii.</td>
<td>procedure and venue for disputes resolution;</td>
</tr>
<tr>
<td>xiii.</td>
<td>time period within which private partner should achieve financial closure of the project; and</td>
</tr>
<tr>
<td>xiv.</td>
<td>supervision mechanism of the implementing agency.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>7</th>
<th>Monitor &amp; Implement the project in accordance with the terms of the agreement.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>a. Because of vague definition of supervision and monitoring mechanism in the PPP contract, the roles and responsibilities of the parties may not be clear, hence timely monitoring, evaluation and feedback may be affected;</td>
</tr>
<tr>
<td></td>
<td>b. Implementing agency may not have the proper expertise to monitor the construction of the project facility and no independent consultants / engineers have been appointed to oversee the construction works.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>8</th>
<th>Submit periodic reports.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>a. Independent experts / engineers may not have been appointed to verify the contents of periodic reports such as construction work progress report, operation and maintenance report, revenue collection report, financial reports etc. submitted by the private partner.</td>
</tr>
</tbody>
</table>
4. SAI PAKISTAN & PPP ARRANGEMENTS

Role and Responsibilities of SAI

The SAI Pakistan has a constitutional mandate. The AGP, who is the head of the SAI Pakistan, is appointed under Article 168 of the Constitution of the country. Article 168 states that:

“There shall be an Auditor General of Pakistan who shall be appointed by the President. The Auditor-General shall, unless he sooner resigns or is removed from office in accordance with clause (5), hold office for a term of four years from the date on which he assumes such office or attains the age of sixty-five years, whichever is earlier”.

4.2 Article 169 and 170 refer to the functions and powers of the Auditor General regarding accounts and audit:

“The Auditor General shall, in relation to (a) the accounts of the Federation and of the Provinces; and (b) the accounts of any authority or body established by the Federation or a Province, perform such functions and exercise such powers as may be determined by or under the Act of Parliament and, until so determined, by order of the President”.

(Article 169)

“The audit of the accounts of the Federal and of the Provincial Governments and the accounts of any authority or body established by, or under the control of, the Federal or a Provincial Government shall be conducted by the Auditor-General, who shall determine the extent and nature of such audit.” (Article 170)

AGP Ordinance 2001

4.3 Apart from the above constitutional provisions, the Auditor General's (Functions, Powers and Terms and Conditions of Service) Ordinance, 2001 describes the auditorial functions and powers of the AGP. Section 8 of the Ordinance, 2001, relating to audit, states that the AGP shall:

“a. audit all expenditure from the Consolidated Fund of the Federation and of each Province and to ascertain whether the moneys shown in the accounts as having been disbursed were legally available for, and applicable to, the service or purpose to which they have been applied or charged and whether the expenditure conforms to the authority which governs it;

b. audit all transactions of the Federation and of the Provinces relating to Public Accounts;

c. audit all trading, manufacturing, profit and loss accounts and balance sheets and other subsidiary accounts kept by Order of the President or of the Governor of a Province in any Federal or Provincial department; and

d. audit, subject to the provisions of this Ordinance, the accounts of any authority or body established by the Federation or a Province, and in each
case to report on the expenditure, transactions or accounts so audited by him.

4.4 Section 9 explains the function of the Auditor General in case of authorities which are financed by governmental loans and grants:

“Where any body or authority is substantially financed by loans or grants from Consolidated Fund of Federal Government or of any Province or of any district, the Auditor- General shall, subject to the provisions of any law for the time being in force applicable to the body or authority, as the case may be, audit the accounts of that body or authority.”

4.5 Section 11 (1) & (2) relates to a situation where any grant or loan is given to a body or authority for certain specific purpose:

“(l) Where any grant or loan is given for any specific purpose from the Consolidated Fund of Federal Government or of any Province or of any district to any authority or body, not being a foreign State or international organization, the Auditor- General may scrutinize the accounts by which the sanctioning authority satisfies itself as to the fulfillment of the conditions subject to which such grants or loans were given and for this purpose have the right of access, after giving reasonable previous notice, to the books and accounts of that authority or body:

Provided that the President, the Governor of a Province or the authority of a district, as the case may be, is of the opinion that it is not necessary to do so in the public interest.

4.6 Section 12 relates to audit of the receipts of the Federation and the Provinces:

“Audit of receipts of Federation or of Provinces or of districts.— The Auditor General shall audit all receipts which are payable into the Consolidated Fund or Public Account of the Federal Government and of each Province and in the accounts of each district and to satisfy himself that all such receipts which are payable into the Consolidated Fund, Public Account or any district account have been properly and correctly deposited and rules and procedures relating to which receipts are being fully observed and the systems are in place to ensure proper assessment and collection of government receipts.”

4.7 In the light of the constitutional provisions and Auditor General’s Ordinance, we need to determine, at least in general terms, what may be the nature and extent of DAGP’s audit of a PPP project. If we recall the definition of PPP as per Public Private Partnership Acts of the Federal as well as Provincial Governments, a PPP arrangement is characterized by commercial nature of transaction between public and private partners. Under the terms of the transaction, the private partner performs function(s) of public partner, assumes the use of public property for project and also assumes substantial risks in performance of public partner’s functions or use of public property. In return, private partner:

i. gets paid by the public partner from its budget/revenue;

ii. collects fees from users of service provided to them; or
iii. gets a combination of both (i) and (ii) above.

4.8 In case of (i) above, when the public partner makes entire payment from public funds to a private partner as a return for performance of certain public function(s), the mandate of AGP to audit the PPP transaction is established in terms of the Articles of the Constitution and Section 8 of the Ordinance 2001. Even, in case of a payment made in the form of loan to finance a PPP arrangement, the audit mandate is established by Sections 9 and 11(1) of the Ordinance 2001, though the nature and extent of audit may need to be modified. This will depend upon factors such as the terms of the loans, the extent of project cost financed through loan etc.

4.9 We will now analyse the implications for the nature and extent of audit, taking into account the PPP modalities employed in Pakistan, i.e., O&M contracts and BOT. We first take the O&M contracts. Under this modality, the private partner provides management services, while funds and operational staff (if so required under the contract) are provided by the public partner. For example, Government of Sindh has handed over management of certain government owned health facilities to private partners. The health facilities will continue to get budget from the Provincial Government and the government employees of these health facilities will continue to work. The private partner will only perform the management function, against a set of mutually agreed KPIs, on behalf of the public partner for consideration of management fee. The private partner assumes no risks except the risk of not being able to perform in accordance with the KPIs. In such a case, the audit mandate is clear and established under the Article 170 of the Constitution and Section 8 (a) of the Ordinance, 2001. There will be no significant difference in the nature and extent of audit of the health facilities before and after their handing over to the private partners.

4.10 The issue of audit mandate becomes complicated when we take into account PPP BOT modality. To analyse the implications of BOT project for audit, let us take the example of an on-going BOT project of a Provincial Government. The project for construction of a dual carriageway has been awarded, after fulfilling all requirements, to a private partner on BOT basis. The private partner is responsible for designing, financing building, operating and maintaining the project facility and transferring back the facility to the public partner after expiry of the concession period. The concession period is 25 years, starting from the date of completion of construction. The salient features of the contract are briefly as under

a. The SPV, incorporated by the private party for implementation of the project, has an equity base of 30% of the total project cost. The share of public partner in equity is 14% and private partner 16%. Remaining 70% cost is arranged by private partner through debt from commercial banks.

b. The public partner is to hand over vacant position of the concession assets /project site to the private partner before the date of commencement of construction.
b. The private partner is responsible for operation and maintenance of dual carriageway throughout the concession period. The major maintenance programs would be vetted by the independent engineer. Payment for the same is to be made by the public partner after certification by the independent auditor.

c. The private partner, as a consideration, will receive semi-annual annuity payments made by the public partner, over the concession period, calculated according to an agreed formula as per PPP contract.

d. An independent engineer will be appointed who will have a defined role during designing, construction, operation and transfer of Concession Assets to review technical matters and report on implementation of project during each phase.

e. An independent auditor will be appointed through a contract entered into between the public partner, the private partner and the independent auditor. The independent auditor will review and give opinion on financial matters.

f. The public partner has the exclusive right to determine, levy, collect, retain and appropriate any toll on the concession assets. The public partner may itself or appoint any operator on its behalf to collect the toll on the concession assets.

g. The private partner is responsible for making arrangements with respect to the installation and operation of an accounting and cost control system and for the appointment, as statutory auditors, of a reputed firm of independent chartered accountants reasonably acceptable to the private partner and the Independent Auditor.

h. The private partner is required to maintain complete and accurate records/ accounting for all transactions which will be subject to inspection and audit by the public partner, the independent engineer and the independent auditor.

i. The private partner in accordance with this Agreement will furnish to the public partner, the independent engineer and the independent auditor the construction monthly progress report and the O&M monthly status report.

4.11 Keeping in view the above, what will be the scope of the DAGP’s audit, given the facts that neither the PPP Act nor the above PPP contract provides for audit of private partner’s (SPV) accounts by the government auditor. Insofar as subjecting the PPP transaction to audit from project identification till the award and signing of the PPP contract is concerned, it may not be problematic. All the relevant record / documents would be available with the public partner. The Provincial
Government has share in equity of the SPV and is also making annuity payments from public funds to the private partner, thus providing a basis for audit as per Section 8(a) of the Auditor General’s Ordinance as it states that “Auditor General shall audit all expenditure from the Consolidated Fund of the Federation and of each Province...” However, if auditors, in connection with their audit, require any documents or records that form part of the accounts of the private partner, the auditors may requisition the same through the public partner.

4.12 The private partner, however, may deny access to its records on the grounds that there is no such provision in the PPP contract that requires audit of private partner’s accounts by the Auditor General. In such a case, the question would be: should the Auditor General modify the scope of audit and rely on the information available with the public partner? Or consider other options like placing the entire PPP transaction under audit observation and reporting the matter to the PAC.

4.13 As far as audit of receipts of toll / user fee is concerned, Auditor General’s mandate is established by Section 12 of the Ordinance, 2001, since the same is being collected by the public partner and deposited in to public fund. Had the PPP contract been such, that instead of annuity payments as consideration, the private partner was given the right to collect and retain toll / user fee over the concession period, the scope of audit of receipts would have likely been affected.

Types of Audit conducted by AGP

4.14 In fulfilling its constitutional duties, the AGP conducts annual audit of the accounts of the Federal Government’s ministries, divisions, attached departments, subordinate offices, autonomous / semi-autonomous organizations and of the accounts of the Provincial departments, organizations and their subsidiaries. Audit of the accounts of District Governments has also been entrusted to the AGP under the Local Government Ordinance. Additionally, some FAOs conduct audit of foreign aided projects funded by the World Bank, Asian Development Bank, and other bilateral and multilateral donors.

4.15 The types of audit conducted by the DAGP include the following:

a. Financial attest focuses on audit opinion on the financial statements and the state of internal controls in the audited entities

b. Compliance with authority audit scrutinizes observance of laws, rules, regulations, and prescribed procedures by the audited entities and leads to reports on their non-compliance

c. Value for money or Performance audit reports on the economy, efficiency and effectiveness in the management of public funds

In addition to the above, special audits are conducted on the directives of the Auditor General, the PAC and on the requests of the heads of executive departments.

Discussion of Public Private Partnership Reports in PAC
4.16 The audit reports prepared by the Department of the Auditor General of Pakistan are discussed in the Public Accounts Committees of the National and Provincial Assemblies. Article 171 of the Constitution states the procedure for disposal of the audit reports produced by the Auditor General:

“The reports of the Auditor General relating to the accounts of Federation shall be submitted to the President, who shall cause them to be laid before the National Assembly and the reports of the Auditor-General relating to the accounts of a Province shall be submitted to the Governor of the Province, who shall cause them to be laid before the Provincial Assembly”.

4.17 The audit reports before finalization and submission to the President or Governor are discussed at the Departmental Accounts Committee level. The DAC comprises of Principal Accounting Officer of the concerned audited entity, and the representatives of the AGP and the Ministry of Finance. An audit report on a PPP project once processed and finalized would be laid before the Parliament / Provincial Assembly for discussion by the respective PAC.

5. AUDIT OF PPP PROJECTS BY FAOS DAGP

The PPP Audit is a new concept for SAI Pakistan. Only a few Field Audit Offices have conducted PPP Projects’ audit in the country so far. During our research, we circulated a questionnaire to the FAOs to ascertain, among other things, the following:

a. The types of PPP audit conducted by the FAOs, if any
b. The audit objectives / audit foci of the PPP audit conducted
c. The audit methodology adopted to gather evidence ; and
d. The opinion of FAO on access to record

5.2 According to the responses we received from FAOs, so far majority of the FAOs have not conducted audit of PPP projects. One of the reasons cited was that no such project was undertaken by government in the FAOs’ audit jurisdiction. There were three FAOs, namely offices of the DG Audit, Sindh, Karachi, DG Audit, Railways, Lahore and DG Audit Works (Provincial), Lahore who informed that they had conducted audit of PPP projects. We present the information provided by the three offices in the following paragraphs

**DG Audit Sindh, Karachi**

5.3 Office of the DG Audit, Sindh conducts audit of accounts of the Provincial Government of Sindh. The office carried out compliance with authority audit of Karachi Mirpurkhas dual carriage highway project. The project was for construction and operation of highway on BOT basis. The Government of Sindh provided 30% of the project cost in shape of soft loan, and the remaining amount was arranged by the private partner in the form of 28.4% equity and 41.6% debt through Consortium of Banks. The other details of the Project are as under:
<table>
<thead>
<tr>
<th>Description</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Length of Dual Carriage Highway</td>
<td>58.70 Kilometers</td>
</tr>
<tr>
<td>Implementing Agency</td>
<td>Works and Service Department, Government of Sindh</td>
</tr>
<tr>
<td>Concessionaire (Private Partner)</td>
<td>M/s Deokjae Connecting Roads (Pvt) LTD.</td>
</tr>
<tr>
<td>Project Cost</td>
<td>PKR 6.2 Billion</td>
</tr>
<tr>
<td>Date of Commencement</td>
<td>1st May, 2010</td>
</tr>
<tr>
<td>Revised Date of Completion</td>
<td>30th June, 2012</td>
</tr>
<tr>
<td>Concession Period</td>
<td>32 years (2 years for construction, 30 years for operations and maintenance)</td>
</tr>
<tr>
<td>Toll Tax</td>
<td>Right of Concessionaire to collect toll tax for 30 years period.</td>
</tr>
</tbody>
</table>

The DG Audit conducted the compliance with authority audit in 2010-11.

9.3.1 Audit Objectives

5.4 The focus of PPP audit, unlike audit of government departments and entities, was on PPP contract, validity of total project cost, economy and efficiency of operations of the entity as seen from the public partner’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.

9.3.2 Audit Scope

5.5 The scope of audit was limited up to agreement conclusion stage, including the financial model. The audit of subsequent stage i.e. the expenditure incurred on the execution of the project was not under the mandate of audit as 100% of the expenditure on execution was to be incurred by the Private Partner.

9.3.3 Audit Methodology

5.6 The audit focused mainly on the following:

a. detailed scrutiny of project documents starting from the conceptual stage to the project formulation and approval stage;

b. review of concession agreement, minimum revenue guarantee agreement, mark-up security guarantee agreement and Escrow Account agreement entered into between the Government of Sindh and the Private Partner; and

c. review of PPP financial model.
**DG Audit, Railways**

5.7 Office of the DG Audit, Railways is responsible for auditing the accounts of Pakistan Railways. The office conducted audit of PPP contracts between Pakistan Railways and private partners for operations and management of passenger trains. The details of the operation and management contracts are as follows:

<table>
<thead>
<tr>
<th>S#</th>
<th>PPP Contract</th>
<th>Year Started</th>
<th>Deliverables by Private Partner</th>
<th>Project Monitored by</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Commercial Management and Passenger Facilitation of Night Coach</td>
<td>2013</td>
<td>Operate night coach between Lahore and Karachi and pay a fixed amount per day to PR</td>
<td>Marketing and Commercial Department, PR</td>
</tr>
<tr>
<td>2</td>
<td>Commercial Management and Passenger Facilitation of Business Express</td>
<td>2012</td>
<td>Operate Business Express between Lahore and Karachi and pay a fixed amount per day to PR</td>
<td>-do-</td>
</tr>
<tr>
<td>3</td>
<td>Commercial Management and Passenger Facilitation of Shalimar Express</td>
<td>2012</td>
<td>Operate Shalimar Express between Lahore and Karachi and pay a fixed amount per day to PR</td>
<td>-do-</td>
</tr>
<tr>
<td></td>
<td>Outsourcing of Hazara Express</td>
<td>2006</td>
<td>Operate Hazara Express between Havelian to Karachi and pay 60% of revenue to PR</td>
<td>-do-</td>
</tr>
</tbody>
</table>

The DG Audit conducted compliance with authority audit of the above PPP contracts in 2015-16.

9.3.4 Audit Objectives:

5.8 The main focus of the audit was on the following:

a. the process of planning and approval for public private partnership in train operations

b. the bidding process adopted by PR in awarding the contracts

c. the viability of PPP contracts to operate the trains

d. the clauses of the contracts which were against the interests of PR or gave undue advantage to private partners
e. PPP contract management, i.e. implementation of the provisions of the contracts and measures taken by the management against any shortcomings
f. Overall performance of the outsourced trains
g. Financial and other benefits derived by PR from the contracts
h. Causes of termination of contract, if any.

9.3.5 Audit Scope:

5.9 The audit was conducted for the period from 2010-11 to 2014-15 in case of contracts relating to Business Express, Shalimar Express and Night Coach. In case of Hazara Express the record was scrutinized starting from 2006. The Audit Team visited following locations during the audit assignment:

a. Ministry of Railways, Islamabad;
b. Chief Marketing Manager, PR, Lahore;
c. Chief Commercial Manager, PR, Lahore;
d. Financial Advisor & Chief Accounts Officer, PR Lahore; and

9.3.6 Audit Methodology

5.10 The methodology adopted to conduct the audit comprised of:

a. Interviews of key resource persons nominated by PR;
b. scrutiny of contract agreements and documentation relating to bidding process; and
c. examination of selected operating activities.

DG Audit Works (Provincial) Lahore

5.11 The DG Audit is entrusted with the audit of the public works departments of Government of Punjab which include Irrigation Department, Communication & Works Department, Public Health Engineering Department and urban development authorities like Lahore Development Authority etc. The office has so far audited only one PPP project, that too, partially during the compliance audit of Lahore Ring Road Authority in 2016-17. While conducting compliance audit of Lahore Ring Road Authority, the audit was restricted to examining certain aspects of Lahore Ring Road (Southern Loop) Project. The Project is still in implementation stage. No specific audit objectives and scope were defined nor any particular audit methodology designed for this audit.

Access to Record

5.12 To our query regarding access to private partner’s record, the three FAQs held the view that the auditors should have access to private partner’s record
when such record are needed by the auditors during audit of PPP projects. The record may be provided to the auditors through the implementing agency or directly by the private partner. The DG Railway Audit, Lahore suggested that auditors, in addition to record, should also have direct access to the offices of the private partners during execution of audit assignment. The DG Audit Sindh, Karachi suggested that minimum level of documentation needed from a private partner may be determined before the start of audit, keeping in view the type of project, financing arrangements, repayment methods etc. A common suggestion was that necessary clause may be added in PPP agreement regarding audit of the project by the FAOs.

5.13 The above three audits of PPP arrangements in Pakistan cannot be made a basis to draw any concrete conclusions. Having said that, we can still make a few general observations from whatever input we got from the FAOs, as under:

a. the focus of audit is more on regularity or compliance issues, though there are references to value for money
b. the audit methodology adopted is, more or less, the same as is used in compliance to authority audits.
c. The audit team faced limitation on scope of audit when it came to audit of PPP project executed on BOT basis; and
d. FAOs suggested that there should be provision in PPP contract regarding audit by the DAGP.

The Way Forward for FAOs

5.14 The DAGP has so far a very limited experience of audit of PPP arrangements. However, in future, as Federal and Provincial Governments enter into more and more PPP contracts, the responsibility of the DAGP to provide legislative oversight in this area will also increase. And, with increased responsibility there will be expectation from all stakeholders, particularly the Parliament and the general public, that the DAGP provides an objective assessment of what was achieved through PPP transaction. Needless to say, there is a strong need to start preparation now to meet the expectations of the stakeholders.

5.15 Having little or no experience of audit of PPP projects makes a few things imperative for the officers and staff of FAOs. First, the auditors by training and by experience are geared to conduct mostly compliance to authority audit of government organizations. In case of PPP, the audit approach as in the case of compliance with authority audit may not be suitable. The audited entity, the PPP, is a product of a horizontal relationship between public and private partners. Unlike government organizations, within which there is vertical relationship and there is hierarchy of controls, the PPP entity works on the basis of shared risks and returns enshrined in the PPP agreement. Since the whole idea of PPP is based on finding innovative ways to improve public service delivery, the auditors would need to understand the need and purpose of each PPP relationship which they are going to
audit. Secondly, innovative partnerships may come up with innovative solutions involving sharing of risks. These solutions may be based on complex financial models, legal relationships about which the auditor may have little know-how. Therefore, capacity building of auditors to equip them with required knowledge and tools is needed.

5.16 Another area that needs improvement is the information available with FAOs about the completed and on-going PPP projects in their audit jurisdiction. While there were a large number of PPP projects that were on going or were operational, the FAOs were almost completely unaware of the same. Perhaps, their pre-occupation with compliance and performance audit have not let them give the needed attention to audit of PPP projects. As a result, rarely any PPP project finds a place in the annual audit plans they prepare. The FAOs need to collect information on PPP projects and tailor their annual audit plans in such a way that some audit resources are kept exclusively for PPP projects’ audit.

6. PRIVATE PARTNERS’ VIEWS ON PPP AUDIT

As we have seen in the last section, except for a few cases, the DAGP has not conducted audit of PPP projects. And, even in the cases of PPP projects audited by the DAGP, almost all of the audit exercises had remained limited to the public partner. The private partners, therefore, did not have first-hand experience of audit by the DAGP. We still considered it to be useful to obtain their views to get some insight into their understanding of audit by a state institution. A detailed interview, in person, was held with a senior member of a private partner’s project management team (SPV).

We put the following three questions:

a. What are the expectations of the management from audit?

b. What are the concerns of the management with respect to audit?

c. What does the management suggest to make the audit more effective for stakeholders?

Expectations of Management

6.2 To our first question, the summary of the reply is reproduced as under:

We / SPV management / Private partner would like to know and understand that under what regulation the government auditors would like to audit us as there is no provision of audit of an SPV by the Department of Auditor General of Pakistan (DAGP) in the applicable Public Private Partnership Act, nor there is such provision in the PPP contract between us and the government agency. According to the PPP contract, our accounts are audited as per regulations of SECP by a statutory auditor (chartered accountant firm) appointed through a process described in the contract. There is also an independent engineer, appointed under the contract, to oversee construction,
operations, maintenance and management of project assets and activities. There is an Independent Auditor (chartered accountant firm) as well appointed under the contract to oversee and check all the project financials, payments, collections and certify the same. We submit periodic reports to the government agency on all the financial and technical matters relating to the project, as per the contract. The independent engineer & independent auditor checks and certifies all our periodical reports before these are sent to the government agency. The government agency, under the contract, can also check our record. Then, there is computerized system i.e. Electronic Toll and Traffic Management System to keep record of collection of all type of users’ fee on daily basis. All the tolls collected are deposited on daily basis in the escrow account which is monitored by the Agent Bank appointed by the Senior Lenders (Banks) and GoS. Electronic cameras, installed at all collection points also keep a daily visual record, on real time basis, of the users availing the project facility. The collection points are subject to random checks by internal audit teams as well as by the statutory auditor. With so many checks and controls already in place, we would like to know what assurances are required for which the state institution (DAGP) need to audit us, what are the objectives of audit?

When told that the DAGP has mandate to audit under the Constitution as well as AGP’s Ordinance, 2001, whenever a transaction involves use of public money or public assets, it was replied that “we believe that in this case if any audit in this regard is required than it could be of the GoS part and not on SPV as all records are transparent and a mechanism of checks and balance are in place according to the contract which is being monitored and audited by many independent parties, external auditors, agent bank, internal audit teams and GoS. - we therefore would expect from the auditors to share with us their audit objectives / scope.”

Concerns of Management

6.3 To our question whether the management has any concerns about audit, the SPV member stated that:

With such a robust and independent audit mechanism in place as mentioned above where the concessionaire / SPV goes through a rigorous process on regular basis throughout the contract period engaging DAGP to audit would be overburdening the SPV and would not be beneficial for future of PPP projects in Pakistan. Apart from these concerns it is felt that the DAGP auditors have experience in auditing accounts of government organizations. Working of a commercial organization is quite different from that of a government organization. Further, the PPP concept has its own peculiarities and the arrangement is relatively new in Pakistan. Before doing an audit it is critically important to understand the PPP concept / arrangement and functioning of an SPV in general and specific to a project as PPP’s are very innovative and one project structuring & arrangements can differ from other. This is critically important in
order to avoid unnecessary issues. Thus, there may be issues on which our and auditor’s understanding may not be the same. Furthermore, the SPV also has no experience of audit by the DAGP. What are their (DAGP) audit procedures? What is the process of preparing and finalizing audit reports? And how audit objections are disposed is not known to us. Government procedures are often cumbersome and time consuming. How long would it take for an audit report to get settled or what would be the consequences for us as well as the Project, if our point of view is not accepted, are also matters of concern for us.

6.4 The concerns of the private partner, thus, emanated from the likely unfamiliarity of each side, the private partner and the auditor, with the working and procedures of the other side.

Suggestions of the Management

6.5 The suggestions regarding audit of PPP projects put forth by the private partner are as under:

First of all, there is a need to bring clarity to the legal basis of audit of PPP projects by the DAGP. While it could be true that the DAGP may have a constitutional mandate to audit, it is also true that under some PPP modalities, the private partner finances the project, through a combination of equity and debt, operates and manages the project facility for a given concession period. In return, the private partner gets the right to receive users’ fee, toll tax etc., during the concession period. Therefore, the financial, operational and revenues risks are transferred to the private partner and public money is not invested in the project. The deliverables on both sides, that is, public and private partners, are determined by the PPP contract. Thus, if at all, SPV is being subjected to audit with respect to the deliverables on the part of the private partner, which we see in this case is already being monitored and certified by various authorities including Government agency as mentioned above therefore we believe that if any audit in this regard is required than it could be of the GoS part and not on SPV. Any additional audit above the existing system would be overburdening the SPV.

Secondly, if still an audit is to be conducted, the TOR for the audit may be determined in advance between the SPV and the auditors. The implementing government agency may facilitate in finalizing the terms. The TOR may cover the audit scope i.e. things such as duration and likely dates of audit, the locations and offices to be visited by the auditors, the record / documents to be produced to the auditors.

Finally, it is suggested that complete understanding / training of the PPP concept should be with DAGP audit team and likewise it would be of great help if the DAGP arranges orientation workshops for private partners in provincial capitals about government audit’s
procedures and processes. This would provide an excellent opportunity to both the private partners as well as the DAGP to interact, exchange ideas and understand each other better.

7. CHALLENGES & RECOMMENDATIONS

Challenges

Delivery of public services through private sector under an established legal framework is a relatively new phenomenon in Pakistan. Legal framework at the federal and provincial level through the promulgation of PPP Acts to regulate private sector’s involvement in financing and operating infrastructure facilities have been established in the recent past. With the passage of time, PPP arrangements are being increasingly employed by the federal and provincial governments while the FAOs have minimal experience of auditing PPP projects. The SAI Pakistan therefore needs to plan how it is going to meet the new responsibility that has come on its shoulder.

7.2 There are elaborate laws providing a legal framework for undertaking PPP projects. However, within the framework there is no provision which provides for PPP audit by the AGP. We have observed that in cases of BOT modality, audit of the SPV is conducted by independent chartered accountants, appointed as statutory auditors as per the terms of contract. The private partners are, therefore, very likely to resist audit of their accounts by the DAGP. Audit by chartered accountant firms would not have been an issue for the AGP, has there been no involvement of public funds or assets. For the reason that, in one way or the other, public resources are employed in PPP projects, it becomes the responsibility of the AGP to ensure accountability over the use of public resources.

7.3 The FAOs face capacity issues when it comes to audit of PPP arrangements. The FAOs have virtually no experience of such an audit. There are complexities involved in PPP arrangements such as complex financial models, risk sharing, cost recovery schemes, legal relationships etc. The skills possessed by FAOs to conduct compliance audit or value for money or performance audit of development projects executed through traditional procurement, are not sufficient to conduct audit of PPP projects. While there is a core of qualified professionals in FAOs, they need specialized training to be equipped with requisite knowledge and tools. The FAOs also need to start collecting and updating information about PPP projects—executed/ completed projects and on-going projects— in their respective audit jurisdictions. With this data base in place, they should systematically plan audit of PPP projects through their annual audit plans.

7.4 The private sector is not familiar with the public auditing procedures and processes. Moreover, while private sector is likely to be more result oriented, the public auditors are likely to give significant weightage to observance of rules and procedures along with the results achieved. There may be many other differences as well. The need is to make the private partners and public auditors aware of the each other’s views and practices regarding financial matters and auditing. This will help in facilitating and ensuring an efficient and effective audit of PPP projects.
Recommendations

7.5 There is a need to bring clarity with respect to the mandate of the DAGP to audit PPP projects, therefore:

a. there shall be unambiguous and specific provisions in the PPP Acts of the Federation and the Provinces regarding audit by the DAGP of PPP projects. The matter needs to be taken up at the appropriate governmental level / PAC and other stakeholders to bring suitable changes in legislation; and

b. in cases of PPP projects which are substantially funded by government, the concerned PPP Authorities may direct the implementing agencies to include PPP contracts a clause for audit of PPP project by the DAGP. Pending any proposed amendment in the available framework, this procedure will remove the impediment in the way of DAGP Audit of PPP arrangements and facilitate the legislative oversight.

The Policy Wing of the DAGP may be assigned to raise the issue with concerned executive and legislative authorities to get the Acts amended. Also, inclusion of requisite clause in PPP contracts may be taken up with the Federal and Provincial Governments at the Policy Wing level.

7.6 Before the commencement of PPP project audit, the FAOs may hold discussion with the concerned PPP Unit / Cell as well as the implementing agency to finalize their audit program to finalize matters like:

d. audit scope & objectives, audit methodologies and duration of audit assignment;

e. record & documents required by audit team, especially from private partner / SPV; and

f. locations & offices to be visited during audit execution.

Any disagreement at this stage may be referred to the next higher level on each side for resolution of the disagreement. Such consultations between the two sides be held to clarify beforehand what is expected from each party and what route the assignment is going to take. In this regard, the initiative would have to be taken by the FAOs to contact the executive authorities to get the issues resolved.

7.7 The DAGP may design a training course specifically tailored for audit of PPP arrangements. The training course shall focus, among other things, on the following:

a. development strategy and objectives of the Federal and Provincial Governments;

b. PPP concepts, objectives and legal framework;

c. PPP project planning, appraisal and approval processes;
d. risk sharing between public and private partners, PPP modalities and financial models used in PPP projects;

e. procurement and negotiation for PPP agreements;

f. monitoring mechanism to protect government’s interest during project implementation and operation; and

g. risks that auditor may focus at different stages of PPP project.

The Pakistan Audit & Accounts Academy may carry out training needs assessment in consultation with the FAOs to finalize the design and duration of the course.

7.8 Each FAO needs to maintain and up-to-date date database of PPP projects that have been implemented, under implementation or in the procurement stage within their audit jurisdiction. For projects which have been implemented / operational and those which are under implementation following details should be collected:

a. the sponsoring implementing agency;

b. the project details such as the PPP modality used and financing arrangements, project cost, project construction period including start and completion dates, project site/location, concession period and cost recovery scheme; and

c. basic information on private partner /SPV.

The FAOs may establish a PPP audit cell within their office and designate an officer of at least deputy director level, trained in audit of PPP projects, to head the cell. The cell should be responsible for collecting relevant information for PPP project data base, liaising with public & private partners and planning & supervising PPP project audit assignments. The FAOs may built in the PPP project audit assignments in their annual audit plan such that a given percentage, say 20% to 30%, of the projects completed in an year are audited in the ensuing year.

7.9 For orientation and understanding of the private partners about government audit, the DAGP in coordination with the Federal and Provincial PPP Authorities may develop brochure / booklets on:

a. audit mandate of the DAGP and its role and responsibilities in ensuring accountability regarding use of public resources:

b. government audit procedures starting from audit requisition for record/ documents, issuance of audit observation memos during execution of audit, exit meeting at the close of audit to discuss audit observations, recording and signing of minutes of exit meeting, issuance of audit report by FAO, and holding of Departmental Accounts Committee meeting to discuss audit reports.
The DAGP, PPP Authorities and implementing agencies may arrange general orientation meetings or project specific workshops, in case of projects having financial outlay of over Rs 5.00 billion, in provincial and federal capitals. The dates and frequency of such workshops may be determined through mutual consultation. The agenda of the meetings / workshops may also be determined in advance through mutual consultation.
7. PHILIPPINES

List of Acronyms

BAC – Bids and Awards Committee
BI – Bureau of Immigration
BOT – Build-Operate-and-Transfer
CALA – Cavite-Laguna
CPA – Citizens’ Participatory Audit
DepEd – Department of Education
DOTr – Department of Transportation
DPWH – Department of Public Works and Highways
EO – Executive Order
GPRAM – Generic Preferred Risk Allocation Matrix
IA – Implementing Agency
ICC – Investment Coordination Committee
IRR – Implementing Rules and Regulations
LGU - Local Government Unit
LRT – Light Rail Transit
MPSS – Minimum Performance Standards and Specifications
MRT – Metro Rail Transit
NAIA - Ninoy Aquino International Airport
NEDA – National Economic Development Authority
ODA - Official Development Assistance
PSIP - PPP for School Infrastructure Project
RA – Republic Act
SLEX – South-Luzon Expressway
VFM – Value For Money

Definition

Public-Private Partnership

A public–private partnership (PPP, 3P or P3) is a government service or private business venture that is funded and operated through a partnership of government and one or more private sector companies.

PPP involves a contract between a public sector authority and a private party, in which the private party provides a public service or project and assumes substantial financial, technical
and operational risk in the project. In some types of PPP, the cost of using the service is borne exclusively by the users of the service and not by the taxpayer. In other types (notably the private finance initiative), capital investment is made by the private sector on the basis of a contract with government to provide agreed services and the cost of providing the service is borne wholly or in part by the government.\textsuperscript{15}

1. Research Background & Methodology

1.1. Background

In November 2014, the ASOSAI Secretariat sent a letter to the Governing Board (GB) members to request for candidate topics for the 11\textsuperscript{th} research project with a list of previous research project topics. A month after, the ASOSAI Secretariat conducted a survey among all ASOSAI members based on their suggested candidate topics.

The result of the survey and discussions among the member SAIs caused the selection of the topic on Audit of PPP Arrangements in February 2015, which eventually confirmed its research team members two months after. \textsuperscript{16}

It is expected that the research report will be presented in time for the 14\textsuperscript{th} ASOSAI Assembly in 2018.

1.2. Project Objectives

This research project is aimed at improving the audit capability of ASOSAI member countries in broadening the vision and deepening the understanding on audit response to PPPs through joint research and the exchange of information and experience on, among others, the following:

1. Legal/statutory frameworks in place for governing and regulating the PPP arrangements.
2. Types of PPP arrangements and sectoral foci and their linkage with the socio-economic priorities.
3. General risk situations faced by the State for the identified PPP arrangements.
4. Roles/responsibilities of research team member SAIs with respect to audit of PPP arrangements.
5. Types of audit of PPP projects thus far conducted by research team member SAIs.
6. Opinion of a representative sample of PPP projects’ management on the hitherto audits conducted by research team member SAIs.
7. Challenges/constraints faced by research team member SAIs in fulfilling their role/responsibilities with respect to audit of PPP arrangements.

1.3. Research Methodology

\textsuperscript{15}Wikipedia.org
https://en.wikipedia.org/wiki/Public%E2%80%93private_partnership
\textsuperscript{16}Asosai.org
201503 The Procedure of the 11th ASOSAI research project.pdf
The project’s research methodology is a combination of descriptive research and problem-oriented research. The following research tools were used in the research project:

**Documents review**

The research team commenced the research work by collecting and reviewing a variety of existing sources (e.g., legislative Acts, Statutory Orders, plans, reports, etc.) relating to the arrangements of PPP in the Philippines and the audits thereof. The purpose was to:

a. get acquainted with the existing arrangements of PPP and their audits;

b. identify weaknesses in the existing arrangements and their causes; and

c. develop measures against identified weaknesses by comparing the practices prevailing and industry best practices.

**Surveys**

Interviews were conducted and questionnaires were administered by the team in order to collect firsthand and reliable information from the related parties viz., audit, public partner and private partner, for the purpose of:

1. confirming the understanding made from document reviews;

2. collecting views of related parties regarding problems in audit and auditee relationship; and

3. collecting proposals of the related parties for problem solving.

**Case Studies**

1. The research team member studied and analyzed typical PPP related audit successes or failures in the Philippines. The intention was to identify PPP audit related problems, and analyze the underlying causes of successful and/or unsuccessful PPP audits conducted by SAI Philippines so that these and proposed solutions for unsuccessful audits can be incorporated in the research project report.

1.4. Summary of Findings and Recommendations

The finding/s of the team on each of the research objectives are as follows:

1. The necessary legal/statutory frameworks for governing and regulating the PPP arrangements are in place. To further enhance these frameworks, nine amendatory bills were filed and are still pending with Congress as at reporting date. Also, the PPP Governing Board, a cabinet level policy making body of the PPP program including secretaries and undersecretaries of the DOF, NEDA and DBM, was established. The Governing Board issues policy circulars formalizing their learning from past projects (refer to page 6).

2. Generally, there are two common forms of PPP structure: availability and concession-based PPPs The two forms could be distinguished from each other based on what the public or private parties assume within the partnership, e.g. rights, obligations, and risks. As to Contractual Arrangement
there are nine types none of which is focused on specific sector (refer to pages 10-12).

3. There is a GPRAM which identifies and allocates between the public and private partners the risks during contract management. This GPRAM does not cover the stages before contract management but it is apparent that legal and regulatory provisions as well as policies and procedures are in place to manage the risks at this stage (refer to page 20).

4. The BOT Law, RA 6957 as amended by RA 7718 expressly mandates the SAI Philippines-Commission on Audit to ensure that the share in revenue of the IA is properly accounted for and received by it; to determine if the mandated return on rate base is complied with, in the case of Public Utility Projects; and to participate in the bidding process as non-voting observer. This is apparently a limitation to the constitutionally enshrined exclusive authority of COA to define the scope of its audit and examination and to establish the techniques and methods required therefor.

5. COA conducts Performance audit as well as financial, compliance and value for money (VFM) audit on some of the PPP projects. Compared to a special audit conducted from July 2004 to February 2005 by Special Audits Office of COA, the audits conducted by the regular audit teams are not as comprehensive as the former (refer to page 31).

6. Among the comments of the projects’ management received insofar as audits conducted on PPP are as follows:

   • Although auditors may not be officially involved in the initial steps of developing PPP projects, the IA will benefit by ensuring the participation of government auditors, even in an advisory capacity, to ensure that transactions are managed in a way that addresses typical audit issues (e.g., lack of feasibility study, sharing of revenues, etc.).

   • There’s a need to clarify the scope of audit, since there are feedbacks from IAs regarding their confusion on what is the scope of the COA audit (refer to page 28).

   • COA Auditors’ should as much as possible be present as witness in every phase of public biddings for PPP projects. While the law requires the IAs to invite a COA representative to witness the proceedings, the attendance of a COA representative is not mandatory but optional (refer to page 28).

7. Among the challenges/constraints COA is facing in fulfilling its mandate insofar as PPP projects are: a. restricted access to documents in the possession of private partners; b. lack of skills/expertise to effectively audit PPP projects; c. Lack of working knowledge of the auditors on PPP laws, rules and regulations, as well as policies and processes (refer to page 30)

To enhance the audit of PPP the general recommendations of the team are as follows (refer to page 32):

1. To assign the audit of all PPP projects to one office composed of people of different discipline and expertise or that has authority to procure needed discipline and expertise for an effective audit of PPP projects;

2. To prepare a PPP Audit Manual;

3. To enhance/update the existing audit guidelines;

4. To capacitate those responsible for the audit of PPPs; and

5. To institutionalize the authority of COA to access documents/information in the possession of private partners.

2. **Existing Legal and Statutory Frameworks in the Philippines, for Governing and Regulating the PPP Arrangements**

   Since there is a need to further enhance the legal and statutory framework for PPPs, the institutionalization of the PPP Center of the Philippines as well as the contingent liability fund through the enactment of the PPP Act and issuance of several policy circulars and guidelines were made.  

Likewise, because of the amended BOT Law in 2012, PPPs are now more flexible not just for BOT projects but also with expanded framework for BOT and other variants. In the last five years of the BOT Center, especially in 2014-2015, the PPP Governing Board was established, a cabinet level policy making body of the PPP Program including secretaries and undersecretaries of the DOF, NEDA and DBM. The Governing Board issued policy circulars formalizing their learning from past projects. Some of the issued policy circulars include Probity Advisers for PPP Procurement, Managing Government Employees Affected by PPP Projects, and Public Consultation and Engagement for PPP Projects.  

Of late, there are news that the constitutional provision that reserves to Filipinos franchises or projects involving public utilities will be among those that may be modified once the constitution is up for amendment. This amendment is deemed necessary to encourage participation of foreign investors in PPP projects. This reported amendment to the constitutional provision is in addition to the nine bills filed and are pending in Congress that seeks to amend the BOT law.

2.2. Existing Situation in the Philippines

**CONSTITUTIONAL**

PPP projects are sanctioned under the 1987 Philippine Constitution specifically Section 20, Article II thereof, which reads: “The State recognizes the indispensable role of the private sector, encourages private enterprise and provides incentives to needed investments”

Section 11, Article XII of the 1987 Philippine constitution however provides a constitutional limitation to the PPP projects involving public utilities. The provision

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18 PPP Center Presentation: PPP Briefing for COA.pdf, slide 24
19 Interview transcription with the PPPC official and staff, November 29, 2016
reads: “No franchise, certificate, or any other form of authorization for the operation of a public utility shall be granted except to citizens of the Philippines or to corporations or associations organized under the laws of the Philippines at least sixty per centum of whose capital is owned by such citizens, nor shall such franchise, certificate, or authorization be exclusive in character or for a longer period than fifty years. Neither shall any such franchise or right be granted except under the condition that it shall be subject to amendment, alteration, or repeal by the Congress when the common good so requires. The State shall encourage equity participation in public utilities by the general public. The participation of foreign investors in the governing body of any public utility enterprise shall be limited to their proportionate share in its capital, and all the executive and managing officers of such corporation or association must be citizens of the Philippines.”

LEGAL FRAMEWORK

To regulate PPP projects, the Philippine Congress enacted Republic Act (RA) No. 6957 as amended by RA No. 7718 or the Philippine Build-Operate-and-Transfer (BOT) Law which provided a more focused framework in PPP infrastructure development.

The enactment of RA 6957 allowed Local Government Units (LGUs) to enter into contractual arrangements with the private sector to implement infrastructure projects through two variants – Build-Operate-and-Transfer (BOT) and Build-Transfer-and-Operate (BTO).

RA 7718 enhances the provision of RA 6957 by broadening the list of PPP government IAs such as government owned and controlled corporations (GOCCs), government financing institutions (GFIs) and state universities and colleges (SUCs); putting in place incentives for attracting private sector investments to venture into PPP projects; and allowing negotiated unsolicited proposals provided that these comply with conditions outlined in the Law. More importantly, RA 7718 provided for the inclusion of other contractual arrangements or schemes to implement PPP projects.

As provided in the amended BOT Law and its Implementing Rules and Regulations (IRR), collaborative partnerships between the government and the private sector can be made possible through a broad spectrum of modalities. The BOT Law identifies a number of variants and includes a catch all provision for other variants that may be identified later. However, project implemented using new variants are subject to the approval of the President of the Philippines.

Other Salient provisions of RA 6957 as amended are as follows:

➢ All projects under the contractual arrangement Build-Own-and-Operate (BOO), a contractual arrangement whereby a project proponent is authorized to finance, construct, own, operate and maintain an infrastructure or development facility from which the proponent is allowed to recover its total investment, operating and maintenance costs plus a reasonable return thereon by collecting tolls, fees, rentals or other charges from facility users, shall be approved by the President of the Philippines.
In negotiated contracts, the rate of return on investment shall be determined by ICC of NEDA prior to the negotiation and/or call for proposals. Also, for negotiated contracts for public utility projects which are monopolies, the rate of return may not exceed twelve per centum (12%).

All government infrastructure agencies, including government-owned and-controlled corporations (GOCC) and LGUs are authorized to enter into contract with any duly pre-qualified project proponent for the financing, construction, operation and maintenance of any financially viable infrastructure or development facility through any of the projects authorized in this Act. Said agencies, when entering into such contracts, are enjoined to solicit the expertise of individuals, groups, or corporations in the private sector who have extensive experience in undertaking infrastructure or development projects.”

Priority projects for implementation by National government Agencies and GOCCs costing up to Three hundred million pesos (P300,000,000) are to be submitted to ICC of NEDA for its approval and to the NEDA Board for projects costing more than Three hundred million pesos (P300,000,000).

Local projects to be implemented by the LGUs are to be submitted, for confirmation, to the municipal development council for projects costing up to Twenty million pesos; those costing above Twenty up to Fifty million pesos, to the provincial development council; those costing up to Fifty million of cities, to the city development council; above Fifty million up to Two hundred million pesos, to the regional development councils; and those above Two hundred million pesos, to ICC of NEDA. All Local Projects costing up to two hundred million shall be approved by the concerned Local Sanggunians.

Unsolicited proposals for projects may be accepted by any government agency or LGU on a negotiated basis subject to certain conditions, as follows: (1) the project involves a new concept or technology and/or are not part of the list of priority projects, (2) no direct government guarantee, subsidy or equity is required, and (3) the government agency or LGU has invited by publication, for three (3) consecutive weeks, in a newspaper of general circulation, comparative or competitive proposals and no other proposal is received for a period of sixty (60) working days. In the event another proponent submits a lower price proposal, the original proponent shall have the right to match that price within thirty (30) working days.”

In the case of build-and-transfer or build-lease-and-transfer arrangement, the contract shall be awarded to the lowest complying bidder based on the present value of its proposed schedule of amortization payments for the facility to be constructed according to the prescribed minimum design and performance standards, plans, and specifications: However, if a Filipino contractor submits an equally advantageous bid with exactly the same price and technical specifications as those of a foreign contractor, the former shall be given preference.
For negotiated contracts, and for projects which have been granted a natural monopoly or where the public has no access to alternative facilities, the appropriate government regulatory bodies, shall approve the tolls, fees, rentals, and charges based on a reasonable rate of return. The imposition and collection of tolls, fees, rentals, and charges shall be for a fixed term as proposed in the bid and incorporated in the contract but in no case shall this term exceed fifty (50) years, but the tolls, fees, rentals, and charges may be subject to adjustment during the life of the contract, based on a predetermined formula using official price indices and included in the instructions to bidders and in the contract. All tolls, fees, rentals, and charges and adjustments thereof shall take into account the reasonableness of said rates to the end-users of private sector-built infrastructure. During the lifetime of the franchise, the project proponent shall undertake the necessary maintenance and repair of the facility in accordance with standards prescribed in the bidding documents and in the contract. In the case of a Build-and-Transfer arrangement, the repayment scheme is to be effected through amortization payments by the government agency or LGU concerned to the project proponent according to the scheme proposed in the bid and incorporated in the contract.

In the event that a project is revoked, cancelled or terminated by the Government through no fault of the project proponent or by mutual agreement, the Government shall compensate the said project proponent for actual expenses it incurred in the project plus a reasonable rate of return thereon not exceeding that stated in the contract as of the date of such revocation, cancellation or termination.

“In the event that the government defaults on certain major obligations in the contract and such failure is not remediable or if remediable shall remain unremedied for an unreasonable length of time, the project proponent/contractor may, by prior notice to the concerned national government agency or LGU specifying the turnover date, terminate the contract. The project proponent/contractor shall be reasonably compensated by the Government of equivalent or proportionate contract cost as defined in the contract.”

Every PPP shall be under the supervision of the said IA, subject to coordination and monitoring by the PPP Center.(EO No. 8 series of 2010, as amended by EO No. 136 series of 2013 mandates PPP center, which is presently under NEDA, to facilitate the implementation of the country’s PPP Program and Projects.)

3. Types of PPP Arrangements and Sectoral Foci Existing in the Philippines and their Linkage with the Socio-economic Priorities

3.1. The types of PPP Projects Prevalent in Research Team Member Countries

Generally, there are two common forms of PPP structure: availability and concession-based PPPs. The two forms could be distinguished from each other based on what the public or private parties assume within the partnership, e.g. rights, obligations, and risks.
3.1.1 Availability PPP- A form of PPP wherein the public authority contracts with a private sector entity to provide a public good, service or product at a constant capacity to the IA for a given fee (capacity fee) and a separate charge for usage of the public good, product or service (usage fee). Fees or tariffs are regulated by contract to provide for recovery of debt service, fixed costs of operation and a return on equity.

While there are no usage fees in this project, an example is the PPP for School Infrastructure Project (PSIP) Phase I wherein the private sector is responsible for making available classrooms (consisting of design, financing, construction and maintenance) for a contract fee with the Department of Education (DepEd).

3.1.2 Concession PPP- A form of PPP wherein the government grants the private sector the right to build, operate and charge public users of the public good, infrastructure or service, a fee or tariff which is regulated by public regulators and the concession contract. Tariffs are structured to provide for recovery of debt service, fixed costs of operation, and return on equity.

An example of a concession PPP is the Ninoy Aquino International Airport (NAIA) Expressway (Phase II) wherein the Department of Public Works and Highways (DPWH) granted the private sector the right to build and operate the expressway. Under the contract, the private sector was given the right to collect a toll (user charge) from the users of the expressway.20

The contractual arrangements for PPP projects are on the other hand as follows:

i. Build-and-transfer (BT). - A contractual arrangement whereby the project proponent undertakes the financing and construction of a given infrastructure or development facility and after its completion turns it over to the government agency or LGU concerned, which shall pay the proponent on an agreed schedule its total investment expended on the project, plus a reasonable rate of return thereon. This arrangement may be employed in the construction of any infrastructure or development projects, including critical facilities which, for security or strategic reasons, must be operated directly by the Government.

ii. Build-lease-and-transfer (BLT) - A contractual arrangement whereby a project proponent is authorized to finance and construct an infrastructure or development facility and upon its completion turns it over to the government agency or LGU concerned on a lease arrangement for a fixed period, after which ownership of the facility is automatically transferred to the government agency or LGU concerned.

iii. Build-operate-and-transfer (BOT) - A contractual arrangement whereby the project proponent undertakes the construction, including financing, of a given infrastructure facility, and the operation and maintenance thereof. The project proponent operates the facility over a fixed term during which it is allowed to charge

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20PPP Website: General forms of PPP
http://ppp.gov.ph/?page_id=27574
facility users appropriate tolls, fees, rentals, and charges not exceeding those proposed in its bid or as negotiated and incorporated in the contract to enable the project proponent to recover its investment, and operating and maintenance expenses in the project. The project proponent transfers the facility to the government agency or LGU concerned at the end of the fixed term that shall not exceed fifty (50) years. This shall include a supply-and-operate situation which is a contractual arrangement whereby the supplier of equipment and machinery for a given infrastructure facility, if the interest of the Government so requires, operates the facility providing in the process technology transfer and training to Filipino nationals.

iv. **Build-own-and-operate (BOO)** - A contractual arrangement whereby a project proponent is authorized to finance, construct, own, operate and maintain an infrastructure or development facility from which the proponent is allowed to recover its total investment, operating and maintenance costs plus a reasonable return thereon by collecting tolls, fees, rentals or other charges from facility users. Under this project, the proponent who owns the assets of the facility may assign its operation and maintenance to a facility operator.

v. **Build-transfer-and-operate (BTO)** - A contractual arrangement whereby the public sector contracts out the building of an infrastructure facility to a private entity such that the contractor builds the facility on a turn-key basis, assuming cost overruns, delays, and specified performance risks. Once the facility is commissioned satisfactorily, title is transferred to the Implementing Agency (IA). The private entity however operates the facility on behalf of the IA under an agreement.

vi. **Contract-add-and-operate (CAO)** - A contractual arrangement whereby the project proponent adds to an existing infrastructure facility which it is renting from the Government and operates the expanded project over an agreed franchise period. There may or may not be a transfer arrangement with regard to the added facility provided by the project proponent.

vii. **Develop-operate-and-transfer (DOT)** - A contractual arrangement whereby favorable conditions external to a new infrastructure project which is to be built by a private project proponent are integrated into the arrangement by giving that entity the right to develop adjoining property, and thus, enjoy some of the benefits the investment creates such as higher property or rent values.

viii. **Rehabilitate-operate-and-transfer (ROT)** - A contractual arrangement whereby an existing facility is turned over to the private sector to refurbish, operate and maintain for a franchise period, at the expiry of which the legal title to the facility is turned over to the Government. The term is also used to describe the purchase of an existing facility from abroad, importing, refurbishing, erecting and consuming it within the host country.

ix. **Rehabilitate-own-and-operate (ROO)** - A contractual arrangement whereby an existing facility is turned over to the private sector to refurbish and operate with no time limitation imposed on ownership. As long as the operator is not in violation of its franchise, it can continue to operate the facility in perpetuity.

3.2. Sectors in which PPP Projects have been Undertaken
The Revised IRR of the BOT Law enumerates the list of activities which may be undertaken under any of the recognized and valid BOT contractual arrangements (PPP modalities) with the private sector. These include, among others:

1. Highways, including expressways, roads, bridges, interchanges, tunnels, and related facilities;
2. Railways or rail-based projects that may or may not be packaged with commercial development opportunities;
3. Non-rail based mass transit facilities, navigable inland waterways and related facilities;
4. Port infrastructures like piers, wharves, quays, storage, handling, ferry services and related facilities;
5. Airports, air navigation, and related facilities;
6. Power generation, transmission, sub-transmission, distribution, and related facilities;
7. Telecommunications, backbone network, terrestrial and satellite facilities and related service facilities;
8. Information technology (IT) and data base infrastructure, including modernization of IT, geo-spatial resource mapping and cadastral survey for resource accounting and planning;
9. Irrigation and related facilities;
10. Water supply, sewerage, drainage, and related facilities;
11. Education and health infrastructure;
12. Land reclamation, dredging and other related development facilities;
13. Industrial and tourism estates or townships, including ecotourism projects such as terrestrial and coastal/marine nature parks, among others and related infrastructure facilities and utilities;
14. Government buildings, housing projects;
15. Markets, slaughterhouses, and related facilities;
16. Warehouses and post-harvest facilities;
17. Public fish ports and fishponds, including storage and processing facilities;
18. Environmental and solid waste management related facilities such as, but not limited to, collection equipment, composting plants, landfill and tidal barriers, among others; and
19. Climate change mitigation and adaptation infrastructure projects and related facilities.21

21 PPP Website: Eligible Types of PPP Projects
http://ppp.gov.ph/?page_id=27574
As of the moment, according to the latest data\textsuperscript{22} of the PPP Center, the following are the sectors in which PPP projects have been undertaken:

1. Environment
2. Information Technology
3. Power
4. Property Development
5. Road Network
6. Transport
7. Water
8. Ferry
9. Food Terminal
10. Government Services
11. Hospitals and Healthcare
12. IT Infrastructure
13. Justice/Corrections
14. Land
15. Port
16. Property Development
17. Rail
18. Real Estate
19. Recreation and Culture
20. Road Network
21. Transport Terminal
22. Transportation
23. Water

3.3 Linkage of PPP Endeavors with Particular Sectors and Driving Factors

According to some PPP Center Officials we interviewed, it is either the need of the sector or the thrusts of the developing partners such as World Bank and ADB that prompts the undertaking of PPP endeavors such as sectoral studies. They cited as an example the rules and regulations issued by the Department of Health (DoH) for health services due to necessity. On the other hand a template/guidelines is being prepared by PPP Center on Water because of the support of the World Bank to the Water Sector.

3.4 Factors Responsible for Preferring Particular Types of PPP Arrangements

\textsuperscript{22}PPP Website: Projects Database
http://ppp.gov.ph/?page_id=26068
In general, governments tap PPP for the following reasons:

1. PPPs encourage the injection of private sector capital.

   National Budget and Official Development Assistance (ODA) are limited and are subject to government prioritization. Private sector funding, on the other hand, is readily available. It may be tapped to augment ODA funds and the government budget to implement critical government projects.

   In the case of big ticket infrastructure projects, PPPs utilize the financial capital of the private sector. Through it, project construction and service delivery is accelerated. For example, the NAIA Expressway Phase II project will be financed through private sector funding. On top of this, the government has received an upfront payment of 11 billion pesos even before the actual project construction.

2. PPPs make projects affordable.

   Government spending will be less if the project is undertaken as a PPP, since the private sector funds their share of the project (including operation and maintenance) during the duration of the concession. PPP projects consider the whole of life costing approach (whole lifecycle costing) which ultimately lowers capital and operating costs.

   All PPP projects undergo a competitive, transparent bidding. PPP project proponents usually provide the most cost-effective capital goods necessary for the project.

3. PPPs deliver VFM.

   VFM is achieved when the government obtains the maximum benefit from the goods and services it both acquires and provides. It is the best available outcome after taking into account all the benefits, costs, and risks over the entire project life, which may not necessarily be the lowest cost or price.

   For the PSIP Phase 1, the PPP scheme was identified as the most optimal financing option available for the government to address the current classroom backlog in the country. Under this scheme, the government will be able to deliver the needed classrooms in the shortest time possible.

4. In PPPs, each risk is allocated to the party who can best manage or absorb it.

   In PPPs, risks are assumed by the party that is best able to manage and assume the consequences of the risk involved.

   PPPs enable the government to take on fewer risks due to shared risk allocation. Generally, the private sector takes on the project’s life cycle cost risk, while the government assumes site risks, legislative and government policy risks, among others.

5. PPPs force the public sector to focus on outputs and benefits from the start.

   Project preparation activities are more rigorous in PPPs. This ensures that the project is highly bankable and can stand public scrutiny. Better project
preparation and execution will result in adherence to project design within the agreed timelines.

In PPPs, the government focuses on providing quality infrastructure and services by setting each project’s minimum performance standards and specifications (MPSS).

6. With PPPs, the quality of service has to be maintained for the entire duration of the cooperation period.

In PPPs, project execution will be more rigorous as project ownership belongs to the project proponents. The public sector only pays when services are delivered satisfactorily.

During the implementation stage, an independent consultant is hired to ensure that both public and private parties adhere to the terms of the contract/concession agreement. This is true in the case of projects presently undergoing—the PSIP Phase 1 and the Daang Hari-SLEX Link Road project.

7. PPPs encourage innovation.

PPPs maximize the use of private sector skills. It utilizes higher levels of private sector efficiency, specialization, and technology.

In the case of the PSIP and the Daang Hari-SLEX Link Road projects, private proponents were given flexibility in coming up with the project design that is most efficient, taking into consideration the MPSS set by the government. However, according to PPPC Officials, there is/are no specific factor/s for preferring particular type of PPP arrangement for a particular sector/project. Selection of PPP arrangements depends on among others risk allocation and attractiveness of proposed project to private sector.

“The PPP structure would be variable on the nature of the project and its technical, financial, legal, and economic viability. In PPP projects, ideally risks should be borne by the party that is best able to manage it. As such, the ICC’s Generic Preferred Risk Allocation Matrix (“GPRAM”) serves as a guide for government entities and the private sector in structuring PPP projects with regard to the risks to be allocated or shared between the government and the private sector. The GPRAM is intended to be recommendatory and envisioned to serve as reference of the ICC and the proponent agencies in the ICC review of PPP projects.

This risk allocation matrix lists the risk allocation preferences, including risk mitigation measures, for consideration by the proponent agencies in the development and implementation of their projects.

The risk allocation for PPP projects are part of the discussion in the ICC, and thus part of the approval parameters for the project. Other parameters include the

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23PPP Website: Advantages of PPP
http://ppp.gov.ph/?page_id=27574
concession period, the required government support /subsidy to the project and the bid parameter to be set during the procurement or bidding of the project.”

These PPP Center Officials mentioned during the interview that there were cases where the projects fall under same sector but were implemented under two different PPP arrangements/structures. Example cited was the project of Centennial and Bulacan, private partners, which are both under Water Sector but were implemented under two different contractual arrangements or the type of PPP arrangement. One was implemented under the Build and Transfer arrangement and the other under the Build-Operate-Transfer arrangement.

4. General Risk Situations in Prevalent PPP arrangements

4.1. Risks to Public Interests at the Conception Stage of PPP Projects

Unlike in the succeeding stages of the PPP Projects where risks are identified and allocated in the GPRAM, during the conception stage, failure to bidding is one of the known risk wherein the government is mostly responsible. The failure to bidding means delay in implementing the project/service and delay in addressing a particular problem where the PPP project is intended to be used.

Other inherent risks at the conception stage are the failure to thoroughly study the viability of PPP projects, to select the best PPP contractual arrangement in implementing priority projects, to identify which of the priority projects will be best implemented under PPP arrangement instead of traditional procurement or vice versa, to protect the interest not only of the private partners but also of the government and the public in contract drafting, review and approval of PPP projects. We would like to believe though that although these risks are not identified and allocated between the public and private partners in the same manner as those during contract management, policies and procedures are in place to manage these risks.

4.2. Risks to Public Interest in PPP Contract Management

Contract management starts from the pre-construction and construction stage, managing and monitoring of Government of the Philippines (GOP) support, monitoring asset condition, variations to project contract, and asset transfer to dispute resolution. During these stages, the following are the risks to public interest in PPP contract management:

Site Risk

1. Existing Structure (refurbishment/extensions) – Risk that existing structures are inadequate to support new improvements or structures/activities subject of or involved in PPP contract, resulting in additional construction, time and cost that may be necessary to replace, strengthen or improve the existing structures to enable it to successfully support the project.

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24Responses from the PPP Center.pdf, page 3
25NGA PPP Manual Volume 3, pp. 5-7
26Generic Preferred Risk Allocation Matrix, page 1
2. **Site Conditions** – Risk that unanticipated adverse geological conditions (geotechnical risk) are discovered which cause construction costs to increase and/or cause construction delays.

3. **Permits and approvals/Site preparation** – Risk that necessary approvals (except for environmental license, environmental management plan, or environmental-related permits/approvals) may not be obtained or may be obtained only subject to unanticipated conditions, which have adverse cost and time consequences (e.g. prolonged delay).

4. **Environmental Liabilities Existing Prior to the Project** – Risk that the project site is contaminated requiring significant remediation expenses.

5. **Environmental Liabilities Created During Operation** – Right that use of the facility/project site over the contract term has resulted in significant environmental liabilities (clean up or rehabilitation required to make the site fit for future anticipated use).

6. **Cultural Heritage** – Risk of costs and delays associated with the discovery of archaeological and cultural heritage attributable directly to the government’s mandated process of conserving, protecting, regulating and disposition of said discovery.

7. **Availability of site** – Risk that tenure/access to a selected site which is not presently owned by government or private partner cannot be negotiated. It is also a risk of costs and delays in negotiating land acquisition.

**Design, Construction, and Commissioning Risk**

8. **Design/Technical Risk** – Risk that the design of the facility is substandard, unsafe, or incapable of delivering the services at anticipated cost and specified level of service (often resulting in long term increase in recurrent costs and long term inadequacy of service.)

9. **Interconnectivity Risk** – Interconnectivity refers to the physical linkage of a project to another. This risk must have been duly considered during the project development as this will affect the design and output specifications of the project.

10. **Interoperability Risk** – Risk associated with achieving clear and efficient operational arrangements with other facility operator/s. This will have to be considered in the project design and operation system requirements.

11. **Construction** – Risk that events occur during construction that prevent the facility from being delivered on time and on cost.

12. **Commissioning** – Risk that either the physical or the operational commissioning tests which are required to be completed for the provision of services to commence, cannot be successfully completed.

**Sponsor and Financial Risk**

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27 Ibid
28 Ibid
13. Interest Rates Pre-Completion – Risk that prior to completion local currency interest rates may move adversely.

4.3. Risks to public interest in the management and use of public assets

The following are the risks to public interest in the management and use of public assets:

**Sponsor and Financial Risk**

1. Interest rates post-completion – Risk that after completion interest rates may move adversely.

2. Exchange rate – Risk that during operation, exchange rates may move adversely, affecting the private partner’s ability to service foreign denominated debt and obtain its expected profit.

3. Inflation – Risk that value of payments received during the term is eroded by inflation.

4. Financing Unavailable - Risk that when debt and/or equity is required by the private firm for the project, it is not available then and in the amounts and on the conditions anticipated.

5. Sponsor Risk – Risk that the private partner is unable to provide the required services or becomes insolvent. The private partner is later found to be an improper person for involvement in the provision of these services. It is also a risk that financial demands on the private partner exceed its financial capacity causing corporate failure.

6. Change in ownership – Risk that a change in ownership or control of the private firm results in a weakening in its financial standing or support or other detriment to the project.

7. Tax changes – Risk that before or after completion, the tax impost on the private firm, its assets or on the project, will change.

**Operating Risk**

8. Inputs/Operating Cost Overrun – Risk that required inputs cost more than anticipated, are of inadequate quality or are unavailable in required quantities.

9. Maintenance and Refurbishment – Risk that design and/or construction quality is inadequate resulting in higher than anticipated maintenance and refurbishment costs.

10. Changes in output specification outside agreed specification range – Risk that government’s output requirements are changed after contract signing whether pre or post commissioning. Change prior to commissioning may require a design change with capital cost consequences depending on the significance of the change and its proximity to completion. Change after completion may have a capital cost consequence or a change in recurrent cost only (for example, where

29Ibid
30Ibid
an increase in output requirements can be accommodated within existing facility capacity).

11. Operator failure/short fall in service quality – Risk that a subcontract operator may fail financially or may fail to provide contracted services to specification (failure may lead to service unavailability and a need to make alternate delivery arrangements with corresponding cost consequences).

12. Technical obsolescence or innovation (Asset Risk) – Risk of the contracted service and its method of delivery not keeping pace, from a technological perspective, with competition and/or public requirements. Private partner’s revenue may fall below projections either via loss of demand (user pays model) and/or payment abatement (availability model) or due to public requirements. Government may not receive contracted service at appropriate quantity/quantity.

**Demand Risk**

13. Demand Risk – Risk that operating revenues falls below forecast as a result of decrease service volume (i.e. traffic volume, water or power consumption) attributable to an economic downturn, competition in the relevant market tariff increases or change in consumer habits.

**Network and Interface Risk**

14. Changes in competitive network – Risk that an existing network is extended/changed/re-priced so as to increase competition for the facility.

**Industrial Relations Risk**

15. Industrial Relations - Risk of strikes or industrial action causing delay and cost to the project.

**Legislative and Government Policy Risk**

16. Approvals – Risk that additional approvals required during the course of the project cannot be obtained.

17. Changes in law/policy – Risk of change in law/policy of government only, which could not be anticipated at contract signing and which has adverse capital expenditure or operating cost consequences for the private firm.

18. Regulation – Risk that where there is a statutory regulator involved there are pricing or other changes imposed on the private firm which do not reflect its investment expectations.

**Force Majeure Risk**

19. Force Majeure Risk – Risk that inability to meet contracted service delivery (pre or post completion) is caused by reason of force majeure events.
4.4. Risks to public interest at the stage of transferring project or assets back to the public sector

The following are the risks to public at the stage of transferring project or assets back to the public sector:

**Asset Ownership Risk**

1. Default and Termination – Risk of loss of the facility or other assets upon the premature termination of lease of other contracts upon breach by the private firm and without adequate payment.

2. Residual value on transfer to government – Risk that on expiry or earlier termination of the services the asset does not have the value originally estimated by the government at which the private partner agreed to transfer it to the government.

5. Prevalent Roles and Responsibilities of Research Team Member SAIs with respect to Audit of PPP Arrangements

5.1. Extent of Statutory Mandate of Commission on Audit (COA) to Carry Out Audit of PPP Arrangements

RA No. 6957 as amended stipulates the mandate of the Commission on Audit insofar as audit of PPP arrangements is concerned. Section 12.19 thereof provides that, “All revenues, share and/or receipts pertaining to or accruing to the Agency/LGU derived from any project proposed under the Act and these Revised IRR, including expenditures or use of funds and property, owned or held in trust by, or pertaining to the Government, shall be subject to examination audit by the Commission on Audit (COA), including i) ensuring that such revenues, share and/or receipts are fully and properly accounted for and remitted to the Agency/LGU, and ii) determining if the mandated return on rate base is complied with, in the case of Public Utility Projects.”

Section 3.1 of the same Act further provides that the BOT Pre-qualification, Bids and Awards Committee shall invite a member of the Commission on Audit as a non-voting observer.

The above-mentioned roles of COA insofar as PPP projects apparently limited its audit jurisdiction over PPP projects considering that the Philippine Constitution, specifically Article IX-D, Section 2(2) thereof, vests in the Commission on Audit the **exclusive authority to define the scope of its audit and examination, establish the techniques and methods required therefor, and promulgate accounting and auditing rules and regulations**, including those for the prevention and disallowance of irregular, unnecessary, excessive, extravagant, or unconscionable expenditures, or uses of government funds and properties.

It is in line with this rule making power that the Commission on Audit adopted thru Resolution No. 99-015 dated October 21, 1999 the BOT Audit Guide. This guide in the audit of PPP projects took into consideration that BOT projects are financed/constructed and oftentimes operated and maintained for a number of

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36Ibid
years by the private sector as well as the enunciated policy in the BOT law of "providing a climate of minimum government regulations and procedures and specific government undertakings in support of the private sector".

Also, under the Revised Administrative Code of the Philippines, COA is empowered to, among others, examine and audit the books, reports, and accounts of public utilities in connection with the fixing of rates of every nature, in relation to the proceedings of the proper regulatory agencies for purposes of determining franchise taxes and subject to certain limitations/conditions to exercise visitorial authority over non-governmental entities whose loans are guaranteed by the government; and those that are subsidized by the government, required to pay levies or have government shares, and have received counterpart funds from the government or are partly funded by donations through the government.

5.2. Mandate of Public Accounts Committees to Give Directives on PPP Audit Reports

The Commission on Audit as an independent constitutional body is not under obligation to comply with the directives of the Public Accounts Committee of the Congress insofar as PPP Audit Reports. As mentioned above, COA has the exclusive authority to define the scope of its audit and examination, establish the techniques and methods required therefor, and promulgate accounting and auditing rules and regulations, including those for the prevention and disallowance of irregular, unnecessary, excessive, extravagant, or unconscionable expenditures or uses of government funds or properties.

6. Audit Experience of COA with respect to PPP Arrangements

6.1. Types of Audits Conducted on PPP Arrangements

Audits of PPP projects in the Philippines are conducted either through regular annual audit by resident audit teams or special audits by visitorial teams.

The scope of regular audits of IAs normally includes financial, compliance and VFM audits. The audit of the PPP project is conducted only in the course of the audit of the operations and the financial statements of the IA for the calendar year and therefore, does not focus solely on the PPP project.

On the other hand, the scope of special audits focuses solely on the specific PPP project which is the subject of the special audit and is more comprehensive compared to the regular audit conducted by resident audit teams of IAs.

6.2. Audit Objectives/Foci of Audits Conducted on PPP Arrangements

The following are audit objectives for each actual audited PPP arrangements:

- To verify compliance with applicable rules and regulations of the concession agreement entered into by the agency and its private counterpart –
Fare Collection System Projects for LRT Lines 1&2 and MRT 3 LRT Line 1 Cavite Extension project of DOTr)

- To determine whether the project is being used, completed on time and had reduced the travel time of the intended beneficiaries.; and to determine whether all the affected residents on right of way (ROW) were paid with just compensation and duly supported with the required documents as required under COA Circular 2012-001 and in accordance with RA 8974 – (Daang Hari-SLEX Road Project (Muntinlupa-Cavite Expressway Project); NAIA Expressway; Cavite-Laguna (CALA) Expressway Project; Laguna Lakeshore Expressway Dike (LLED); NLEX-SLEX Connector Road Project; Plaridel By-Pass Road (Arterial Road Bypass Project, Phase II); and Manila Bay Integrated Flood projects of the DPWH.)

- To determine whether the procurement in CY 2014 strictly followed the Philippine BOT Law Revised IRR No. 6957 as amended by R.A. 7718; to determine whether the school buildings were constructed based on the intended site and to determine the existence of Building Permit; to determine whether the school buildings constructed is in compliant with plans and specifications per Bid Proposals/ Contracts and per MPSS as checked by the Independent Consultant; To determine whether the project is completed on time and in accordance with approved program of works; and to determine whether all completed sub projects were duly recorded in the books upon the end of the lease period (for PSIP I ) and issued a certificate of completion as validated by the Independent Consultant –(PSIP I project of the DepEd.)

- To verify whether the procurement is not disadvantageous to the government; to verify whether related expenditures are accurate, valid and authorized; and to validate whether capitalized expenditures are in accordance with the generally accepted accounting principles and auditing standards – (BATMAN Natural Gas Study Project of the PNOC.)

- To assess the efficiency and effectiveness of the implementation of BOT projects under the ICT sector in protecting the interest of the government and the public – (Civil Registry System Project of the National Statistics Office (NSO); Information Technology Project of the Land Transportation Registration Authority (LRA); for the Machine Readable Passport/Visa Project of the Department of Foreign Affairs (DFA); and Alien Certificate of Registration Identification Card Project of the Bureau of Immigration)

6.3. Audit Methods used in Audits Conducted on PPP Arrangements

In order to obtain enough audit evidence in auditing the sample PPP projects, following were some of the audit procedures employed:

- Reviewed relevant standards, model guidelines, frameworks on BOT Law, additional ICT Guidelines on BOT Projects, ICC NEDA Handbooks/Guidelines on BOT and its variant schemes and other related materials from international bodies/organizations.

- Attended briefings and interview concerned officials of BOT/PPP Center, ICC NEDA and IAs on the implementation of the BOT/PPP program/project.
• Evaluated the reasonableness of contract provisions and compliance with relevant BOT regulations.
• Reviewed and evaluated accomplishment reports.
• Reviewed procedures and criteria adopted for the preparation and evaluation of proposals, prequalification, bid documents, awards and other related activities/documents.
• Reviewed pertinent project documents from selection, approval and award of project to project implementation.
• Reviewed general and application controls concentrating on the adequacy of internal control in the application systems and deliverables under the project.

7. Views of PPP Project Management regarding Audits by COA

7.1. Views regarding Contribution of Audit towards better Project Management

Auditors may not be officially involved in the initial steps of developing PPP projects. However, the IA will benefit by ensuring the participation of government auditors, even in an advisory capacity, to ensure that transactions are managed in a way that addresses typical audit issues (e.g., lack of feasibility study, sharing of revenues, etc.).

In an interview conducted with the official and personnel of the PPPC, it was mentioned that there’s a need to clarify the scope of audit, since they received feedbacks from agencies and GOCCs regarding their confusion on what is the scope of the COA audit.

A PPPC official told us that COA Auditors’ should as much as possible be present as witness in every phase of public biddings for PPP projects. While the law requires the IAs to invite a COA representative to witness the proceedings, the attendance of a COA representative is not mandatory but optional.

7.2. Suggestion regarding Improvements Required in Audit Services

According to a response from one of our agency respondents, they expect that COA will use the same basis as required by applicable laws, rules and regulations on the audit of PPP projects. Also, a complete list of required documents with timelines needed for the audit is suggested to be given as manuals to agencies.

Likewise, in an article published by the PPPC through their website, they suggested to identify the audit principles and define types of PPP audit by issuing a PPP Audit Guide. Preliminarily, the following seven principles are suggested: (1) Public good and better quality of life, not financial considerations alone, is the true measurement of PPPs; (2) Expansive, not restrictive, view of PPPs; (3) Innovation and liberality, rather than stringency and route thinking; (4) Exclusion, rather inclusion, of private funds in audit scope; (5) Performance-orientation, beyond fault-finding; (6) Remedial measure as against substitution of judgment and stymieing of discretion; and (7) Institutionalization of people’s audit through accredited CSOs.

Anchored on these principles, the COA should undertake or enhance the following five audit schemes: (1) **Public Good Audit**: to determine the impact and benefit to the people of PPP projects; (2) **Regularity Audits**: to ensure compliance with laws and approval processes (compliance audit) and to monitor revenues, recording and accounting of government income, expenditures, contributions, assets and liabilities, and internal controls (financial audit); (3) **Performance Audits**: to safeguard against unnecessary and imprudent expenditures and to check attainment of key performance indicators based on the contract; (4) **Forensic Audits**: to correct fraud and corruption in the implementation of the project; and (5) **Participatory Audits**: to engage the CSOs in making sure that purpose of the project is achieved.38

7.3. Limitations of the Private Partner in Providing Relevant Auditable Records

Based on an interview conducted, one of the Project Development Officers of PPPC said that the private sector would be very reluctant to provide documents in their possession based on consultations they’ve done with them before. She believes that the private partners cannot be compelled to provide documents, except financial reports. She however suggested that if COA needs some documents, they may obtain them through the IA as the IA may oblige the private partner to give needed documents within reason.

8. Challenges Faced by COA in Fulfilling their Role and Responsibilities with respect to Audit of PPP Arrangements

8.1. Adequacy of Legal Cover

According to the results of the survey conducted for concerned COA auditors involved in the audit of PPP projects, the following are the challenges/constraints experienced and observed as regards the adequacy of legal/statutory framework:

a. The inadequacy in the legal/statutory framework only lies on the contract review of the project. Since it is a PPP project and being financed by a Concessionaire, there should be definite guidelines to be used for contract review.

Assessing the stages of the PPP Project Cycle (Development, Approval, Competition and Cooperation), it is my impression that the issue of RROW acquisition can only be planned after the Notice of Award has already been issued to the Concessionaire. The tendency is that all RROW Costs shall be borne by the GOP Counterpart and as a consequence project implementation would be delayed in the event that problems arise because of lot owners’ refusal during actual implementation. The same scenario should have been addressed during the “Development Stage” and in the “Preparation of Detailed Engineering Design” to promote efficiency in project implementation.

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38PPP Website, Why audit of PPP contracts by COA the next hurdle, http://ppp.gov.ph/?in_the_news=why-audit-of-ppp-contracts-by-coa-the-next-hurdle
b. Inability to fully understand the manner/process in undertaking the different contractual arrangement under the BOT Law.

c. Conflict arises in the manner the law is interpreted vis–a-vis application

8.2. Capacity Issues

Respondents to survey administered cited the following challenges insofar as issue on capacity:

a. Complexity of the PPP projects.

b. No audit program provided in the audit of PPP.

c. Lack of technical knowledge with regard to the subject.

d. It cannot be said the Auditors lacks skills on the audit of PPP. It is just that there are no definite guidelines for its review and audit. DPWH, for the government side, only undertake the identification of project/s, procurement process and the supervision/monitoring of project implementation. DPWH is also tasked for payment of Right-of-Way (ROW) for which a regular post audit is being made on payments to the affected residents.

e. Lack of Contract Review skills that hinders the auditor’s capacity to recognize whether the law is correctly applied in the provisions of the contract.

f. Auditors are not fully equipped with knowledge to audit the whole process.

g. The Minimum Performance Standards is highly technical for the auditor’s appreciation. Thus the quality of the school buildings constructed may not be fully assessed.

h. Computation of the amortization with present value considerations are highly technical in nature thus, may not be subjected to reasonableness test.

i. New technological methods used in construction require a different set of technical skills in order to determine whether it would be practical for the government to undertake the projects.

j. Need to equip and train auditors about the procurement scheme under the Public-Private Partnership

k. Insufficient knowledge and information on the detailed procedures to be undertaken

l. Need for consultation with professional experts on PPP who would be able to provide relevant and accurate information

m. Need to attend relevant training in order to develop our auditorial skills on PPP

n. Since the applicability of PPP is limited to few agencies there are no manual/guidelines issued for the Audit of PPP. Thus, auditors are confined to their own strategies/technique that may not be necessarily effective or are limited to cover the whole process.
o. Although the audit has been performed, no industry standards would assess on the quality and effectiveness of the audit conducted.

p. Inability to assess the quality of outputs/performance of agency under audit

q. Inability to determine on whether that contract undertaken is more advantageous to the government

8.3. Difficulties in Interacting with Private Partners

COA auditors encounter difficulty in accessing certain documents in the possession of the private partners implementing PPP projects, as private partners most of the times deny the auditors access to these documents. The auditors however have access on all documents in the possession of the IA and at times could gain access to documents in possession of the private party through the IA.

9. Overall Conclusions

The following are the overall conclusions based on the research made by COA:

Except for the special audit conducted by Special Audit Office, the audits so far conducted are not adequate for the following reasons:

1. The audits conducted by auditors of IA were focused mainly on compliance to relevant laws rules and regulations as well as conformity of parties to contract terms and conditions, compared to that conducted by the special audit which was more comprehensive;

2. Respondent resident Auditors didn’t have the material time to fully understand the Law and IRR on PPP projects as they are assigned to audit more than one client and perform comprehensive audit-Financial, compliance and VFM Audits - on each.

3. Certain disciplines and expertise, which COA presently does not have, are needed for an effective audit of PPP projects.

10. General Recommendations

The following are the general recommendations based on the existing conditions in the audit of PPP projects:

1. To assign the audit of all PPP projects to one office composed of people of different discipline and expertise or that has authority to procure needed discipline and expertise for an effective audit of PPP projects;

2. To prepare a PPP Audit Manual;

3. To enhance/update the existing audit guidelines;

4. To capacitate those responsible for the audit of PPPs; and

5. To institutionalize the authority of COA to access documents/information in the possession of private partners.
Abstract

In a review of literature and experience gained, this paper evaluates auditing issues with regard to Public Private Partnerships. Evaluation was made on the various interests within with a focus on government leadership in statutory, public good, sectoral needs and management areas. The findings of this paper suggest that the timing for Supreme Audit Institution (SAI) involvement in PPP audits depend on many factors, but the need to effectively manage large amount state assets requires that SAIs should be ready to become engaged at all stages of a PPP.

Key words: public private partnership, SAI involvement

List of Acronyms

BPK                         Supreme Audit Institution of Indonesia
CGI                         Center for Government Investment
GCA                         Government Contracting Agency
GOI                         Government of Indonesia
IIGF                        Indonesia Infrastructure Guarantee Fund
MoF                         Ministry of Finance of the Republic of Indonesia
PPP                         Public Private Partnership
SAI                         Supreme Audit Institution
SOE                         State-Owned Enterprise
KKPPI                        Committee for the Policy on the Acceleration of Infrastructure Development (2001)
KPPPIP                      Committee for Acceleration of Priority Infrastructure Provision (2014)
OGM                         Operational Guidelines Manual

Definitions

1. A Public Private Partnership, hereinafter referred to as PPP, is the cooperation between a government(s) and a business entity(s) in provision of infrastructure for the public interest. In general, such provision is made in accordance with specifications agreed upon between the various regional or national government parties such as ministries, institutions, agencies, state/region owned enterprises and private sector business actors. Central to any agreement is an understanding of the business entity’s resources to be allocated and the risk to be allocated between the parties. In the context of Indonesia, an outline of specifications are provided primarily in Government Regulation No. 38 Year 2015 concerning Cooperation Between Government and Business Entities in Infrastructure Provision, Article 1, No. 6.

CHAPTER 1

RESEARCH BACKGROUND AND METHODOLOGY

1.1. Background

As in many countries, the availability of adequate and sustainable infrastructure is an urgent need for Indonesia to support national development in order to improve the national economy, the welfare of society and the
competitiveness of Indonesia in a global context. In order to accelerate infrastructure development, it is necessary to take comprehensive steps to create an investment climate that encourages the participation of business entities in the provision of infrastructure based on principles of good corporate governance.

According to Indonesia’s Middle Term National Development Planning (2009-2015), the funding needed for infrastructure projects was projected at amounted IDR 6,780 trillion (US$521 billion). The government’s ability to finance the infrastructure project had been projected at only 52%, with approximately 28% directly financed by state-owned enterprises, loans, mortgages, and other financing, leaving a financing gap of 20% expected from private sector involvement.

This need to find alternative ways of infrastructure financing encouraged the creation of a public-private partnership financing schemes to provide public infrastructure goods/services. Critical in achieving success is that PPP are conducted based on the principles of fairness, openness, transparency, and competition. This is especially true in the procurement process, where transparency and competition promote: (i) increasing public acceptance of PPP projects; (ii) encouraging financial institutions to provide financing without government guarantees; (iii) reducing the risk of project failure; (iv) attracting highly experienced and high-quality bidders; and (v) preventing government officials from corrupt, collusive and nepotistic practices.

The benefits of having private sector participation in PPP in the infrastructure sector are there: (i) ability in seeking private capital to bridge large financing capital required for public service infrastructure investment; (ii) experience in natural resource management and service facilities; (iii) access to imported technology transfer; and (iv) operational efficiency track records, while private sector companies benefit by expanded and developed services and customers.

1.2. Objectives of this Paper

This research on PPP in Indonesia is intended to achieve the following research objectives:

1. Detail a legal/statutory framework for regulating PPP.
2. Identify the types of PPP and their linkage with socio-economic priorities.
3. Ascertain the general risk situations faced by SAI for PPP.
4. Describe the roles/responsibilities of SAI with respect to PPP audits.
5. Review some PPP audits conducted by BPK.
6. Collect opinion on a representative sample of PPP management success via audits conducted by BPK.
7. Identify challenges/constraints faced by SAIs in fulfilling their role/responsibilities with respect to PPP audits.

1.3. Research Methodology
This research is conducted as a qualitative approach. It will follow the documentary method, which is represented in the historical information and data concerning PPP auditing. The researcher conducted a document review of existing Indonesian sources such as the constitution, laws, government regulations, presidential regulation/decision, ministry regulations, long-term plans, research reports, project reports, guidelines, and audit reports.

This research also follows descriptive method by using a case study approach to identify and analyze audit success or failures and the most important obstacles faced by the PPP projects and ways to overcome these obstacles.

1.4. **Summary of Findings and Recommendations**

Research on PPP in Indonesia uncovered several findings as follows:

1. Success or failure of a PPP project in Indonesia should not be the responsibility of government and private sector only, but also need the involvement from the external audit institution (SAI) and internal audit institutions. The comprehensive control or oversight can be conducted by all parties through:
   
   (1) monitoring and evaluation by government agencies; (2) compliance audit and performance audit by external audit institution (BPK); and (3) supervising and review by internal audit institution.

2. BPK's auditors conducted the PPP audits only in a limited scope and only in a compliance audit.

3. BPK auditors have no comprehensive audit guidelines related to PPP audits.

In an effort to assist the government and private parties in realizing PPP projects economically, efficiently and effectively, some recommendations to be proposed to improve the PPP audits are as follows:

1. BPK and Indonesian ministerial internal audit institutions should make arrangements or memorandum of understanding in order to outline areas for PPP audits, supervision and oversight to avoid overlapping of duties.

2. In order to achieve the reasonable quality of PPP project, BPK should prepare the audit guidelines containing at least the following: (1) an overview of the PPP mechanism; (2) institutional arrangement for appraisal and approval of PPP projects; (3) scope and objectives of PPP audits; (4) mandate of PPP audit and accessibility to records; (5) auditing process and criteria of PPP audit; and (6) reporting audit findings and recommendations.

3. BPK should expand the audit type conducted in PPP project from only compliance audits to performance audits.

The purpose and direction of these recommendations are to clarify the roles and responsibilities of all oversight bodies in PPP projects. In the context of SAI, the ability to have predictable access to PPP data and the ability to conduct performance audits will elevate a SAI's position to a higher level of maturity in PPP projects, from oversight level to
insight level, and generate guidance that will support a successful outcome for all parties in the PPP, government and private sector.

CHAPTER 2

PPP ARRANGEMENTS STATUTORY FRAMEWORKS

In 1997, during the early part of the Asian crisis, the Government of Indonesia (GOI) through the Ministry of National Development (Bappenas) reviewed Government-Private Sector Cooperation Arrangements under the various ministries and state-owned enterprises (SOE’s). This Bappenas review concluded that: structural reforms tended to lag behind (with little progress in pricing and subsidy reform), the regulatory framework was not sufficiently credible, and proper competition was not adequately addressed. Projects tended to be procured through a non-transparent unsolicited process, giving rise to poor governance and corruption, collusion and nepotism. From this review, it was considered that an effective system must be in place to oversee Government-Private Sector Cooperation Arrangements and a national policy of cross-sector policy and regulatory framework for PPP was proposed.

2.1. Need of Comprehensive Legislative and Statutory Frameworks

Public Private Partnerships, especially in infrastructure sector, began in 1998 with issuance the Presidential Decision No. 7 Year 1998 on Cooperation Between Government and Private Business Entities in Infrastructure Construction and Management. The overall thinking was that infrastructure development was important to support and realize gradual and continuous national development while the government was not able to fully finance all proposed infrastructure projects.

The Constitution of the Republic of Indonesia Year 1945, as amended four times, has no clear Article addressing PPP, while Article 33 indicates that infrastructure development warrants government involvement as it is important for national development. The Presidential Decision of 1998 connected private sector involvement with the government strategy to accelerate infrastructure development. Article 33 paragraph (1) Constitution of Indonesia: “Sectors of production which are important for the country and affect the life of the people shall be under the powers of the State”.

Presidential Decision No. 7 Year 1998 was replaced by Presidential Regulation No. 67 Year 2005 on Cooperation Between Government and Business Entities in Provision of Infrastructure in order to conform to Presidential Decision No. 80 Year 2003 on Public Procurement, Article 51 stating that “the provision of goods / services conducted through the cooperation between government and business entities will be arranged by Presidential Regulation”.

Presidential Regulation No. 67 was amended several times as follows:

· Presidential Regulation No. 13 Year 2010 on First Amendment of Presidential Regulation No. 67 Year 2005;
Presidential Regulation No. 56 Year 2011 on Second Amendment of Presidential Regulation No. 67 Year 2005;

Presidential Regulation No. 66 Year 2013 on Third Amendment of Presidential Regulation No. 67 Year 2005.

In order to implement these Presidential Regulations, various implementation rules were made as follows:

- Presidential Regulation No. 78 Year 2010 on Government Guarantee for Cooperation Project between Government and Business Entities Provided by Infrastructure Guarantor Company;

- Minister of Finance Regulation No. 260/PMK.011/2010 on Implementation Guidelines for Infrastructure Guarantee in the Cooperation Project between Government and Business Entities; and


Presidential Regulation No. 38 Year 2015 on Cooperation Between Government and Business Entities in Infrastructure Provision superseded Presidential Regulation No. 67 Year 2005 and its amendments. There were four considerations underlying the issuance Presidential Regulation No. 38 as follows:

a. the availability of adequate and sustainable infrastructure as an urgent need to support the implementation of national development in order to improve the national economy, the welfare of society and the competitiveness of Indonesia in a global context;

b. in order to accelerate infrastructure development, it is necessary to take comprehensive steps to create an investment climate that encourages the participation of private sector business entities in the provision of infrastructure based on principles of good corporate governance;

c. in order to encourage and improve cooperation between government and private sector business entities in the provision of infrastructure and social services, it is necessary to protect and safeguard the interests of consumers, communities and business entities equitably;

d. the cooperation can be done in a expeditious, effective, efficient, comprehensive and sustainable way.

Presidential Regulation No. 38 consists of general provisions, purposes and principles of PPP, types of infrastructure and forms of cooperation, establishment of the Government Contracting Agency (GCA), land acquisition, return on investment of the private sector business entity, PPP based on initiative from a business entity, government support and government guarantee, partial funding of
PPP by government, PPP planning, PPP preparation, PPP transaction, PPP node, transitional provisions, and closing provisions.

According to Presidential Regulation No. 38 Article 3, the purposes of conducting a PPP are:

a. to meet the funding needs for infrastructure provision in a sustainable manner through the use of private funding;

b. to accomplish infrastructure provision with quality, effectiveness, efficiency, accuracy, and promptness;

c. to create an investment environment that promotes the participation of private sector business entities in infrastructure provision based on principles of good corporate governance;

d. to promote the principle that the user pays for the service received, or in certain cases considering the ability of the user to pay; and/or

e. to provide certainty to private sector business entities about the return on investment in the infrastructure provision through periodic payments by government to the private sector business entity.

PPPs in Indonesia have followed the below general principles:

a. Partnership, meaning that cooperation between governments and private sector business entities is conducted based on laws and on stipulations that take into account the needs of both parties;

b. Benefit, meaning that infrastructure provision is conducted by governments with private sector business entities to provide social and economic benefits for society;

c. Competition, meaning that the decision process to partner with a private sector business entity is conducted fairly, openly and transparently, with consideration to the principle of fair business competition;

d. Risk control and management, meaning that cooperation in infrastructure provision is conducted with an assessment of risk, and the development of a risk management and mitigation strategy;

e. Effectiveness, meaning that cooperation in infrastructure provision is able to accelerate the development as well as increase the quality of infrastructure management and maintenance services; and

f. Efficiency, meaning that cooperation in infrastructure provision helps meet the funding needs in a sustainable way through the support from private funding.

In Indonesia to achieve these general principles through regulation, Minister of National Development Planning Regulation No. 4 Year 2015 on Procedures for Implementation of Cooperation Between Government and
Business Entities in the Provision of Infrastructure was based on Presidential Regulation No. 38 of 2015 Article 46 paragraph (1) on Cooperation Between Government and Business Entities In Infrastructure Provision, which stated:

“Further provisions on the procedures for implementation of the cooperation between Government and implementing Business Entities in Infrastructure Provision will be governed by regulations of the ministry responsible for government affairs in the field of national development planning”.

2.2. Existing Situation in Indonesia

Presidential Decision No. 7 Year 1998 defined the GOI’s policy on PPP and how to monitor such projects. Key policy objectives included expanded infrastructure investment and to receive greater value for money from PPP projects. It set out the broad principles transparency and competitive bidding and protection of the interests of the consumer and investor under which PPP projects were to be undertaken.

Regulation making was also assigned to Bappenas, with the responsibility to produce an Operational Guidelines Manual (OGM). Bappenas was thus charged to oversee and administer PPP programs, being responsible for monitoring implementation and compliance with Presidential Decision No. 7 Year 1998, as well as identifying and prioritizing projects to be undertaken on a PPP basis. The Procurement Evaluation Team, an inter-ministerial body, was established and approval from this team is required before a PPP concession will be awarded.

Presidential Decision No. 7 Year 1998 included the following types of infrastructure projects able to be included in a PPP scheme:

- Power plant, transmission and distribution;
- Natural gas transmission and distribution;
- Petroleum and natural gas processing and transportation, including processed product;
- Water treatment production, storage, supply, and distribution;
- Waste and sewage treatment;
- Procurement and/or operating supporting facilities of goods / mass transportation in sea/water, air, and train;
- Toll road and toll bridge, docks, seaports, river ports, lake ports, runways and airports;
- Procurement and operating of telecommunication facilities.

Since promulgation of Presidential Decision No. 7, the administrative machinery for implementation of regulation has undergone significant changes and reform, especially with the establishment of the Committee for the Policy on the Acceleration of Infrastructure Development (KKPPI), appointed with Presidential
Decision No. 81 Year 2001, and chaired by the Coordinating Minister for the Economy, two vice chairman, and eight members.

The Committee has authorities, as follows:

a. Formulating policies and strategies for accelerating infrastructure development including creating conducive conditions to increase private investment and cooperation between governments and the private sector in infrastructure development;

b. Coordinating the integration of plans and programs, and monitoring the policy implementation to accelerate infrastructure development;

c. Solving various problems related to infrastructure development.

From 1998 to 2004, there had been no significant progress in starting PPP projects. This phase was a consolidation period due to the spillover from the Asian financial crisis and the change in the Indonesian political system. Government agencies and ministries introduced the PPP scheme for infrastructure projects to stakeholders and from 2005 to 2009, some strategies were created, namely (1) laying the foundation for PPP project implementation through policy and regulatory reform to adopt international best practices; (2) setting up PPP institutions, PPP network and PPP campaigns; and (3) identification of potential PPP projects and implementation of some PPP projects (see Figure 1 below).

Presidential Decision No. 81 Year 2001 was amended by Presidential Decision No. 42 Year 2005, extending the authority of the KKPPI “to formulate policy on public service obligation in the acceleration of infrastructure provision”. Lastly, Presidential Regulation No. 75 Year 2014 on Acceleration of Priority Infrastructure Provision established the Committee for Acceleration of Priority Infrastructure Provision (KPPIP). This committee replaced the existing committee, KKPPI, and has authorities as follows:

a. Establishing strategies and policies in order to accelerate the provision of priority infrastructure;

b. Monitor and control the implementation of strategies and policies in order to accelerate the provision of priority infrastructure;

c. Facilitate the enhancement of institutional and institutional capacity related to the provision of priority infrastructure;

d. Establishing the quality standards of the pre-feasibility study and evaluation procedures;

e. Facilitate the preparation of priority infrastructure; and

f. Settle any problems arising from the implementation of priority infrastructure provision.

To execute the authorities, the KPPIP is assisted by the Executive Team and Working Team. Up to 2009, Indonesia achieved the PPP project with status in operation, under construction, and concession awarded, as follows:
- In operation: (a) toll road, 20 sections, 607 km; (b) power sector (IPPs), 12 projects at approximately 4,000 MW; (c) ports, 4 projects: 2 in Jakarta, 1 in Surabaya, and 1 in Batam; and (d) water sector, 27 projects;

- Under construction: (a) toll road, 4 sections; (b) IPPs, 13 projects; and (c) water supply, 2 projects; and

- Concession awarded: (a) toll road, 17 projects; (b) IPPs, 29 projects; and (c) water supply, 1 project.

According to the Bappenas PPP Book 2009 – 2015, an overview of the progress of the PPP project status of already tendered, ready to offer, prospective, and potential is presented in Figure 1 below.

![Figure 1. Progress of PPP Project from 2009 – 2015](image)

(Source: Bappenas Public Private Partnership Infrastructure Project Plan in Indonesia 2015)

From the above description of the initial parallel development of PPP policy, implementation mechanism, statutory basis, principles and actual small scale implementation, the involvement of an SAI was not integral to getting the PPP structure understood and functional. Ministry level audits, SOE audits, and private sector business entity audits were undertaken without a national PPP audit framework with SAI audits, as we will see below, taking only an oversight role.
CHAPTER 3
PPP TYPES, SECTORAL FOCI AND LINKAGE WITH SOCIO-ECONOMIC PRIORITIES

Due to the various circumstances and differing needs of the various types of infrastructure investments, in Indonesia and in other countries, a variety of approaches are needed to best balance risk and return while provide services at an optimum level. The below section details project types, project sectors, project examples, driving factors and socio-economic criteria, all of which must be linked together towards creating PPP projects that can achieve successful outcomes.

3.1. The types of PPP Projects

The following types of PPP projects have been and are being carried out in Indonesia:

a. Build, Operate, Lease-hold and Transfer (BOLT): the government hands over land to a private entity upon which structures will be built and managed (including the subcontracting of this to other parties) for a certain duration of time, at which time the project is then handed over to the government after the contract expires.

b. Build Own Operate (BOO) is a granting concession on the construction of an infrastructure project whereby an investor has right to get return of investment, also viewed as a reasonable profit, allowing that investor to withdraw a specific fee with government approval.

c. Build Own Operate Transfer (BOOT): the private sector finances, builds, operates, maintains, manages and collects payments from users of an infrastructure project, and at the end of the Right of Use, hands the project over to the government.

d. Build Operate Transfer (BOT) is a contractual granting of concessions to the private sector for a certain period. The private sector develops the project, including its financing, and operates the infrastructure, and then hands the project over to the government after the contract expires. [ed. based on the above two definitions, I cannot determine a difference.]

e. Build Transfer (BT): the private sector carries out construction activities and financing according to the contractually agreed time. After the construction of the project is completed, the private sector entity hands it over to the government. The government is required to pay to the private sector for the value of the investments incurred plus the fair profit.

f. Build Transfer Lease (BTL): a private sector entity builds the infrastructure on government land. The infrastructure belongs to the government, and a/the [ed. is it only the constructing entity or any private sector entity gains an option to lease?] private sector entity has the option to lease.
g. Build Transfer Operate (BTO): a private sector built infrastructure project, including financing, and when completed the infrastructure is handed over to the government, the payment of funding is fixed within a certain period and the private sector leases it long-term.

h. Concession Contract (CC): the private sector provides management services for part or all of certain infrastructure project, including the operation and maintenance of facilities and the provision of services to the public and the provision of working capital.

i. Operation Maintenance (OM): government and private contracts to operate and maintain public service facilities.

j. Service Contract (SC): The private sector is given the responsibility of performing services for a particular type of service within a certain period of time.

k. Joint Venture: responsibility and ownership shared, with balanced positions aimed at integrating private advantages such as capital, technology, management and governmental superiority in authority and public trust.

l. Divestiture or divestment: is the release of partial or total ownership of a government asset to the private sector. Government control over this now private sector project is only on business licensing or services.

3.2. Sectors in which PPP Projects have been Undertaken

Bappenas has PPP projects listed in four categories: (a) already tendered list; (b) ready-to-offer project list; (c) prospective project list, and (d) potential project list. According to the Bappenas Public Private Partnership Infrastructure Project Plan in Indonesia 2015, there were 22 projects already tendered up to middle of 2015 as follows:

Table 1. Already Tendered PPP project list (until middle of 2015)

<table>
<thead>
<tr>
<th>No.</th>
<th>Project Name</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Central Java Coal Fired Power Plant</td>
<td>Development of power plant in Central Java, approximately 2,000 MW</td>
</tr>
<tr>
<td>2</td>
<td>Umbulan Water Supply, East Java</td>
<td>Development of bulk water supply system (4,000 l/s) and transmission pipeline (106 km)</td>
</tr>
<tr>
<td>3</td>
<td>Puruk Cahu – Bangkuang Coal Railway</td>
<td>Development of a dedicated coal transportation system in Central Kalimantan</td>
</tr>
<tr>
<td>4</td>
<td>Bandar Lampung Water Supply, Lampung</td>
<td>Development of bulk water and extraction raw water from Way Sekampung river.</td>
</tr>
<tr>
<td></td>
<td>Project Description</td>
<td></td>
</tr>
<tr>
<td>---</td>
<td>---------------------------------------------------------</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Development of toll road in Capital Special Region – Jakarta Province, from Kemayoran to Kampung Melayu (9.65 km)</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Development of toll road in Capital Special Region – Jakarta Province, from Sunter to Batu Ceper (22.92 km)</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Development of toll road in Capital Special Region – Jakarta Province, from Ulujami to Tanah Abang (8.27 km)</td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>Development of toll road in Capital Special Region – Jakarta Province, from Pasar Minggu to Kasablanka (9.56 km)</td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>Development of toll road in Capital Special Region – Jakarta Province, from Sunter to Tambelang (25.73 km)</td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>Development of toll road in Capital Special Region – Jakarta Province, from Duri Pulo to Kampung Melayu (11.38 km)</td>
<td></td>
</tr>
<tr>
<td>11</td>
<td>Development of toll road in Bali Province, from Nusa Dua to Benoa (9.70 km)</td>
<td></td>
</tr>
<tr>
<td>12</td>
<td>Development of existing cruise ship terminal to accommodate two large cruise ships and expansion of jetty to accommodate cruise ships up to 300 m length</td>
<td></td>
</tr>
<tr>
<td>13</td>
<td>Development of toll road in North Sumatra Province, from Medan – Kuala Namu – Tebing Tinggi (61.30 km)</td>
<td></td>
</tr>
<tr>
<td>14</td>
<td>Development of waste treatment plant by incineration process, with electricity as output</td>
<td></td>
</tr>
<tr>
<td>15</td>
<td>Development of toll road in Banten Province, from Serpong to Balaraja (36.30 km), will connect Jakarta – Serpong toll road and Tangerang – Merak toll road</td>
<td></td>
</tr>
<tr>
<td>16</td>
<td>Development of coal fired power plant 2 x 600 MW in South Sumatera Province</td>
<td></td>
</tr>
<tr>
<td>17</td>
<td>Development of coal fired power plant 1 x 600 MW in South Sumatera Province</td>
<td></td>
</tr>
<tr>
<td>18</td>
<td>Development of waste treatment to reduce solid waste</td>
<td></td>
</tr>
<tr>
<td>No.</td>
<td>Project Name</td>
<td>Description</td>
</tr>
<tr>
<td>-----</td>
<td>--------------------------------------------------</td>
<td>-----------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>19</td>
<td>Consolidated Urban Development, Banda Aceh</td>
<td>Development of new terminal (bus station) and commercial areas of Keudah, revitalizing old CBD Peunayong, maintenance of District Peunayong drainage and sanitation.</td>
</tr>
<tr>
<td>20</td>
<td>Solid Waste Treatment and Final Disposal – Bogor and Depok Area, West Java</td>
<td>Development of waste treatment plant with RDF and compost as output</td>
</tr>
<tr>
<td>21</td>
<td>Kayu Agung – Palembang– Betung Toll Road, South Sumatera</td>
<td>Development of toll road in South Sumatra Province to connect Kayu Agung, Palembang, Betung (111.69 km)</td>
</tr>
<tr>
<td>22</td>
<td>Pasir Koja – Soreang Toll Road, West Java</td>
<td>Development of toll road in West Java Province, from Pasir Koja to Soreang, Bandung Municipal (15 km)</td>
</tr>
</tbody>
</table>

Source: Bappenas, PPPs Infrastructure Projects Plan in Indonesia, 2015

The overview of PPP projects with status: ready to offer, prospective projects, and potential projects is presented in Table 2, Table 3, and Table 4.

### Table 2. Ready-to-offer PPP project list

<table>
<thead>
<tr>
<th>No.</th>
<th>Sub Sector</th>
<th>Name of Project</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Railway</td>
<td>Soekarno-Hatta International Airport – Halim Perdana Kusumah Airport Railway</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Bandung Light Rail Transit (LRT), West Java</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Tanjung Enim – Tanjung Api – Api Railway, South Sumatera</td>
</tr>
<tr>
<td>2</td>
<td>Water Supply</td>
<td>West Semarang Water Supply, Central Java</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Pondok Gede Water Supply, Bekasi, West Java</td>
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<tr>
<td></td>
<td></td>
<td>Pekanbaru Water Supply, Riau</td>
</tr>
</tbody>
</table>

Source: Bappenas, PPPs Infrastructure Projects Plan in Indonesia, 2015
Bappenas listed three sub-sectors of prospective project, are: (a) railway; (b) toll road and toll bridge; and (c) power.

Table 3. Prospective PPP project list

<table>
<thead>
<tr>
<th>No.</th>
<th>Sub Sector</th>
<th>Name of Project</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Railway</td>
<td>Integrated of Gedebage Multipurpose Terminal (Railway), Bandung, West Java</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Development of South Sumatera Monorail, South Sumatera</td>
</tr>
<tr>
<td>2</td>
<td>Toll road and toll bridge</td>
<td>Manado – Bitung Toll Road, North Sulawesi</td>
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<tr>
<td></td>
<td></td>
<td>Tanjung Priok Access Toll Road, DKI Jakarta</td>
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<td></td>
<td></td>
<td>Balikpapan – Samaringan Toll Road, East Kalimantan</td>
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<td></td>
<td></td>
<td>Cileunyi – Sumedang – Dawuan Toll Road, Wes Java</td>
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<tr>
<td></td>
<td></td>
<td>Pandaan – Malang Toll Road, Eas Java</td>
</tr>
<tr>
<td>3</td>
<td>Power</td>
<td>Karama Hydro Power Plant, West Sulawesi</td>
</tr>
</tbody>
</table>

Source: Bappenas, PPPs Infrastructure Projects Plan in Indonesia, 2015

Bappenas listed six sub-sectors of potential project are: (a) sea transportation; (b) air transportation; (c) railway; (d) toll road and toll bridge; (e) solid waste and sanitation; and (f) power.

Table 4. Potential PPP project list

<table>
<thead>
<tr>
<th>No.</th>
<th>Sub Sector</th>
<th>Name of Project</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Sea transportation</td>
<td>Development of Malloy International Port, East Kalimantan</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Expansion of Kabil Port (Tanjung Sauh Terminal), Batam, Riau Islands</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Development of Kuala Tanjung International Hub Port, North Sumatera</td>
</tr>
<tr>
<td>2</td>
<td>Air transportation</td>
<td>Development of New Bali Airport, BaliKulonprogo International Airport, DI Yogyakarta</td>
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<tr>
<td></td>
<td></td>
<td>Expansion of Mutiara Airport, Central Sulawesi</td>
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<td></td>
<td></td>
<td>Expansion of Komodo Airport, East Nusa Tenggara</td>
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<td></td>
<td></td>
<td>Expansion of Radin Inten Airport, Lampung</td>
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<td></td>
<td></td>
<td>Expansion of Juwata Airport, North Kalimantan</td>
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<td></td>
<td></td>
<td>Expansion of Sentani Airport, Papua</td>
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<td></td>
<td></td>
<td>Expansion of Tjilik Riwyt Airport, Central Kalimantan</td>
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<td>Expansion of Fatmawati Soekarno Airport, Bengkulu</td>
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<td></td>
<td></td>
<td>Expansion of H. AS. Hananjoeddin Airport, Bangka-Belitung Islands</td>
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<tr>
<td></td>
<td></td>
<td>Expansion of Matahora Airport, Southeast Sulawesi</td>
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<tr>
<td></td>
<td></td>
<td>Expansion of Sultan Babullah Airport, North Maluku</td>
</tr>
</tbody>
</table>

| 3 | Railway | Development of Batam Railway, Riau Islands |
|   |         | Pulau Baai – Muara Enim Railway, Bengkulu – South Sumatera |

| 4 | Toll road and toll bridge | Batu Ampar – Muka Kuning – Hang Nadim Toll Road, Riau Islands |

| 5 | Solid waste and sanitation | DKI Jakarta Sewage Treatment Plant, DKI Jakarta |

| 6 | Power | Tebo Mine Mouth Coal Fired Steam Power Plant (2 x 200 MW), Jambi |

Source: Bappenas, PPPs Infrastructure Projects Plan in Indonesia, 2015

3.3. **Linkage of PPP Endeavors with Particular Sectors and Driving Factors**

The Government of Indonesia conducts the PPP mechanism in infrastructure project with several reasons or factors as follows:

a. Better Development Technology:
   
   - Government will save on maintenance costs;
   - To extend development;
· To transfer technology to local companies; and
· To build creative and innovative facilities.

b. Budget Solution and Risk Transfer:
· To overcome the government budget constraints;
· To transfer risk to private entities; and
· To reduce the time of project execution.

c. Public Sector Financing Efficiency:
· To reduce the public sector administration cost, public fund allocated within the investment, and project cost.

3.4. Factors Responsible for Preferring Particular Types of PPP Arrangements

The GOI established the following criteria to be considered when selecting the type of PPP arrangement:
· The project or service cannot be funded / implemented by the funding sources and expertise of the public sector;
· Private partners are able to improve the quality or level of service over that organized by the public sector only;
· Services or projects in the sector allow for innovation;
· Partnership will encourage economic development of the region;
· The existence of support from service users on the need for private partner involvement;
· Private partners are able to accelerate the process of managing services or projects over that of the public sector only;
· Be able to allocate and mitigate the risk in equal measure;
· There is a chance to compete among prospective private partners;
· Costs for services / projects can be recovered from the imposition of service fees;
· Outputs and tariffs on services should be easily measurable;
· The absence of provisions impedes the straightforward involvement of the private sector in carrying out services or projects in the sector; and
· The existence of a track record in cooperating with private sector entities.
CHAPTER 4
RISK IN PPP

Some of the risks in PPP projects are similar to those of private sector businesses in general and can be assessed and included into project cost projections. Other risks need to be and can be addressed by targeted government involvement to overcome unacceptable uncertainties that prevent private sector involvement in certain PPPs. The below list highlights the importance of considering and detailing all risks so as to establish mitigation mechanisms and/or factor in costing.

4.1. Risks to Public Interests at the Conception Stage of PPP Projects

The Indonesia Infrastructure Guarantee Fund (see below) has identified PPP risks at the conception stage as: location risk, design risk, construction risk, and operational test risk, sponsorship risk, political risk, interface risk, and force majeure.

4.1.1. Risk of Location

Location Risk is a risk group in which project land is unavailable or cannot be used on a predetermined schedule and/or within an estimated cost; or that a location may incur a material burden or liability for a particular party. Thus, the risks falling into this category are:

a. Land acquisition risks: risks associated with land acquisition processes required by the project, which may involve potential for additional costs and delays;

b. The risk of land location non-conformity: the risk that the proposed land location cannot be used for the project, where the causes may include contamination, artefact discovery, delays / rejection of acquisition of planning approval, land status, and others;

c. Environmental risk: the risk of loss due to environmental damage occurring (1) as a consequence of construction and operation activities during the life of the project, or (2) from prior to the transfer of project land from Government Contracting Agency (CGA) to business entities or sub-contractors.

4.1.2. Risks of Design, Construction, and Operational Test

Risks of Design, Construction and Operational Tests are that the design, construction or operation of a project facility and/or element of the process is carried out in a manner that negatively impacts project costs and/or resulting services. Thus, the risks falling within this category are:

a. Risk in planning: the risk that the use of the proposed project site in the PPP agreement and, in particular, construction of the facility is inconsistent with applicable regulations relating to planning or land use; or that late or unenforceable licensing is obtained; or any of the above result in a greater than expected cost;
b. Design risk: the risk at which the business entity’s design cannot meet the required output specification;

c. Risk of settlement: the risk in which the completion of the work required by a project may: (1) be late, so that the provision of infrastructure services cannot commence according to a predefined Commercial Operation Date (COD), or (2) be late, unless greater costs must be incurred to maintain the already scheduled COD, or (3) be late, due to other changes occurring;

d. Risks of rising costs: the risks in which in the design and/or construction stage, the cost of project realization exceeds project cost projections;

e. Operating test risk: the risk that a test of operations is delayed or the result does not meet the specifications of the GCA or other authority.

4.1.3. Sponsorship Risk

Sponsorship risk is the risk that the business entities and / or its subcontractors cannot fulfill their contractual obligations to the GCA due to the actions of private investors as project sponsors.

4.1.4. Political Risk

Political risks are risks triggered by any non-predictable actions of statutory change or GCA that materially and adversely affect the return on equity and/or loan requirements. Risks that fall into this category are:

a. Risk that local currency cannot be converted or transferred: the risk that the revenue / profit from the project cannot be converted into foreign currency and / or repatriated to the investor’s home country;

b. Risk of regulatory and regulatory changes, which are discriminatory and specific in nature so as to directly reduce the financial viability of the project, triggered either by actions of the GCA or other government entity;

c. Sub-sovereign or parastatal risk: the risk that the GCA is unable or unwilling to perform the obligations of contract payments or other material obligations as triggered in relation to its status as a government entity;

d. Permission risk: the risk that the necessary licenses from other government entity cannot be obtained or, if obtained, required a greater cost than projection;

e. Risk of tax rate change: the risk of a changing applicable tax rate (income tax rate, VAT) or new taxes that may decrease expected equity returns.

4.1.5. Interface Risk

Interface risk is the risk that the method or standard of service provision will hinder or interfere with the provision of services made by the public sector entity or vice versa. These risks include when the quality of work undertaken by the government is inconsistent / incompatible with that of the business entities, or vice versa.
4.1.6. Force Majeure

Force Majeure is the risk of an unexpected incident which is completely beyond the control of both parties, either natural or human-caused, and will result in delay or default by either government or private sector business entities in the execution of contractual obligations.

4.2. Finance Risks

Finance risk is an important matter after the PPP contract is signed by the interested parties. Finance risk is related to the feasibility of project financing as:

a. The risk of financing uncertainty: the risk that the funding party (debt or equity) will not or cannot continue the commitment to provide project funding;

b. Financial parameters risk: the risk of changing financial market parameters such as inflation rate, exchange rate, market conditions before the contractor has completed the tender process and secured access to financing for the project, potentially adversely affecting project costs;

c. The risk of financial structure: the risk that the financial structure is not resilient or flexible enough to deliver optimum results including the balance of debt and equity portions during the project period, therefore perhaps disrupting the sustainability or feasibility of the project;

d. Insurance risks: (i) that risks that were previously insurable at the date of signing in accordance with the agreed project then become uninsurable or (ii) remain insurable but with significant increase in insurance premiums.

In the area of financing risk, the GOI prepared mechanisms to overcome the various constraints in financing PPP projects. The Ministry of Finance, as part of its implementation regulation, addressed efforts to improve creditworthiness of PPP projects by:

- Establishing the Indonesia Infrastructure Guarantee Fund (IIGF), to provide government guarantees or credit enhancements only to PPP projects that are financially feasible;
- Establishing PT SMI to facilitate and catalyze PPP infrastructure projects through provision of debt, equity and mezzanine financing;
- Establishing Indonesia Infrastructure Finance, a non-bank financial institution, to provide long-term funding for infrastructure projects; and

4.3. Risks to Public Interest in Management and Use of Public Assets

This risk is related to the management and use of public assets, namely risk of operations, risk of network connectivity, risk of revenue, and risk of asset ownership.

4.3.1. Operational Risk

Operational risk is the risk that the process of providing infrastructure services in accordance with the contract or any element of the process, including inputs used as part of the process, will be affected in a way that prevents private
sector business entities from providing contracted services in accordance with agreed specifications and / or as per cost projection. The risks under this category are:

a. Maintenance risk: the risk that (i) the realization of project asset maintenance cost is materially higher than the projected maintenance cost, or (ii) there is a negative impact due to poor maintenance;

b. The risk of latent defects: the risk of loss or damage arising from hidden defects in project assets;

c. Technology risk: where (i) the technology used has the potential to fail to produce the required output specifications, or (ii) technological developments make the technology used obsolete (risk of technological obsolescence);

d. Utility risk: the risks in which (i) the utilities such as water, electricity or gas required for project operations are not available, or (ii) there are project delays due to delays in connection or relocation of utilities for the project site;

e. Resource or input risk: the risk of failure or lack of supply of inputs or resources such as coal or other fuels required for project operations, including deficiencies in the quality of available supplies;

f. The risk of industrial relations: the risk of any form of industrial action, including demonstrations, work restrictions, blocking, restraints and strikes, occurs in a way that, directly or indirectly, negatively impacts the operational tests, service delivery or project feasibility.

4.3.2. Risk of Network Connectivity

In the case of a multi-phased project where one PPP project links into other completed phases, the risk of network connectivity is the risk of a negative impact on the service availability and financial feasibility of the project due to changes in current network conditions or future network changes. Risks included in this category are:

a. Connectivity risks with the existing network: the risk that access to the existing network will not (be) built as planned;

b. The risk of network development: the risk that the additional network needed is not (so) built according to plan;

c. Risk of competing facilities: the risk that the construction of similar facilities / infrastructure will then rival the output of service provision according to the contract.

4.3.3. Revenue Risk

Revenue risk is the risk that project revenue cannot meet the projected level for financial feasibility, due to unexpected changes in either project demand or an agreed tariff or a combination of both. The risks under this category are:
a. Demand risk: the risk that the realization of service provision is unexpectedly lower than projection because of: 1) incorrect assessment of trigger factors by the government, or 2) incorrect assessment made by the private sector in estimating the volume of demand and in market responses over time; and

b. Tariff risk: the risk that the service tariff is lower than projection because: 1) periodic tariff adjustments are not made as planned or the tariff rate is set lower than projection, or 2) error in tariff estimates or non-compliance with standards required for the tariff adjustment requests.

4.3.4. Risk of Asset Ownership

The risk of asset ownership is the risk of occurrence of events such as loss events, such as breach of contract, force majeure, and technological changes, cause the asset's economic value to decline, either during or after the end of the contract period.

4.4. Risks to Public Interest at Stage of Project/Asset Transfer to Public Sector

Asset ownership risk include asset loss event risk and asset transfer after the PPP contract ends. The asset transfer process may be hampered because there is a difference in the mechanism of transfer or assessment.

CHAPTER 5

SAI ROLES AND RESPONSIBILITIES IN PPP AUDITS

5.1. Extent of Statutory Mandate for BPK to Carry Out PPP Audits

Audit of PPP can be conduct in compliance audit or performance audit. The audit mandate has been stated in Article 23E of Indonesia’s Constitution:

(1) In order to audit the management and responsibility of the state finances, a free and independent Audit Board shall be established.

(2) The results of the audits of state finances shall be submitted according to relevancy to the People's Legislative Assembly, Regional Representatives Councils, and Regional People's Legislative Assemblies.

(3) The results of the audit shall be followed up by the legislative and / or agency in accordance with the law.

Further Law No. 17 Year 2003 Article 2 states: “State Finances as referred to in Article 1 paragraph 1, include: g. state/regional assets managed on its own or by other parties in the form of cash, securities, receivables, goods and other rights that can be valued in money, including assets separated on state enterprise/local company; and i. assets of other parties obtained using facilities provided by the government. According to Law No. 17 Year 2003 Article 2, g on State Finance, PPP projects are under the scope of state finance.
CHAPTER 6

BPK PPP AUDIT EXPERIENCE

To date, BPK has undertaken audits of only two PPP projects, both of which under State-Owned Enterprises. Both findings indicate the BPK and the GOI should seek to prioritize and expand PPP audits.

6.1. Types of Audits Conducted on PPP Arrangements

According to Indonesian Law No. 15 Year 2004 on *Audits of Management and Responsibility of State Finances*, BPK can conduct the three types of audits:

1. financial audit;
2. performance audit; and
3. special purpose audit, i.e., compliance audit or investigative audit).

BPK auditors may audit PPPs in two types: performance audits and compliance audits.

6.2. Audit Objectives/Foci of Audits Conducted on PPP

This section presents the audit objectives and audit foci from BPK audit reports submitted to the legislature bodies (House of Representatives and Senate).

6.2.1. Audit report of Infrastructure Financing and Guarantee of PT Sarana Multi Infrastruktur (Persero) 2014 to 2016

Audit objective: to assess the compliance of regulations by PT Sarana Multi Infrastruktur (Persero) related to infrastructure financing and guarantees. The audit focus was:

a. regulations and policies related to infrastructure financing and guarantee;

b. executing of infrastructure financing and guarantees.

6.2.2. Audit Report of Ngurah Rai Airport Management and Investment Activities in Bali at State-Owned Enterprise PT Angkasa Pura I (Persero) and its subsidiary.

The audit objectives were:

a. to obtain the adequate understanding of PT Angkasa Pura I (Persero) internal control system in order to assess the risk and reasonable control for safeguarding of PT Angkasa Pura I (Persero) assets and assess whether the internal control system was designed and implemented adequately to achieve the objective of control.

b. to obtain an adequate understanding and assess the conformity of Ngurah Rai Airport management and investment with the regulation and prepare a conclusion.

The audit focus was:

a. management activities of Ngurah Rai Airport by PT Angkasa Pura I (Persero) and by a third party within the PPP.
b. investment activities such as construction of Ngurah Rai Airport, apron, taxiway, and passenger terminal, hotel, condotel, construction and maintenance of domestic terminal.

6.3. Audit Methods used in Audits Conducted on PPP Arrangements

This section presents the part of audit report namely audit methods, audit findings, and recommendation.

6.3.1. Audit report of Infrastructure Financing and Guarantee of PT Sarana Multi Infrastruktur (Persero) 2014 to 2016

**Audit methods.**

Audit is done by collecting data by sample, interview, confirmation and limited physical observation. Furthermore, there is evidence analysis and conformity assessment between the evidence and the audit criteria. The results of the assessment will be set forth in the form of audit findings used to formulate the conclusions of audit and improvement suggestions.

**Audit findings.**

The financing of construction of the coal gas power plant at Melak, Regency of West Kutai, East Kalimantan Province was not based on an adequate feasibility assessment and its implementation is not fully compliant with applicable regulations/prevaling provisions, resulting in bad debts. The Auditor presented several problems as follows:

(1) The approval of financing was not based on an adequate feasibility assessment:

   (a) the appraisal of the credit rating of the private sector financing business partner does not consider the constrained rating of the private sector construction company;

   (b) the credit agreement does not contain any arrangements in relation to risk mitigation related any difficulty in rating appraisals;

(2) The implementation of the financing agreement was not fully compliant with the prevailing provisions and was not adequately controlled:

   (a) the revenue from the sale of electricity from the PPP private sector operational partner to PT Sarana Multi Infrastruktur was not directly placed into the designated depository account;

   (b) the disbursement of the sixth loan funds can still be made even though the private sector business partner has not signed the sale and purchase agreement;[ed. this seems unclear from the above, and especially so given the below non-functioning status. Advise delete.]

   (c) monitoring of the financing of the private sector financing business partner without re-rating each year;
(d) additional financing facilities not in accordance with the original agreement;
(e) use of funds by the private sector construction business partner inconsistent with the initial agreement;
(f) disbursement of financing under PT SMI guarantee was still carried out after the termination of the agreement;
(g) change of financing scheme by involving regional private sector financing companies was not accompanied by adequate control over the proceeds from the sale of electricity.

(3) The condition of the Coal Gas Power Plant Melak is as a not feasible operation;
(a) Coal Gas Power Plant is out of operation;
(b) The water treatment plant was not built as planned and does not function;
(c) The gas tank was not built and does not function;
(d) Coal waste contaminates the surrounding environment; and
(e) Gasification engines and gas engines are not functioning.

(4) Insufficient collateral as well as uncertainty of project continuation and repayment of financing.

**Recommendation.** PT SMI resolves bad financing and in the case of any violation of law, to process such matters in accordance with applicable regulations.

6.3.2. Audit Report of Ngurah Rai Airport Management and Investment Activities in Bali at PT Angkasa Pura I (Persero) and its Subsidiary.

**Audit methods:**

a. Planning stage. Auditor obtained data and information of entity and internal control system, assessment of audit risk; and selection of sampling method;

b. Execution stage. Auditor conducted analytical review, limited test of internal control, substantive test or transaction and activities; and completion of field work;

c. Reporting stage. Auditor prepared the audit report based on the audit findings. Audit team discussed the audit report draft with supervisor, and signing officer.

**Audit findings.**

- Finding #1. The appointment of private sector business partners to manage the airport commercial areas was conducted in a non-transparent and non-independent manner. The Auditor presented several problems as follows:
(1) The winning bidder is not one of business entities that submits tender documents.

(2) The Commercial Strategic Business Unit (SBU) temporarily leases the advertising medium without a contractual agreement, but only based on the approval letter from the General Manager and Co-General Manager of the Commercial SBU and without approval Board of Directors of PT Angkasa Pura I (Persero); and

(3) The winning bidder resigned after being appointed as the winner.

· Finding #2. The cooperation agreement on airport commercial management resulted in a loss to PT Angkasa Pura I (Persero), with the following issues:

(1) management fee is paid out of performance and results achieved by the private sector business partner; and

(2) payment of overseas marketing expenses and business development without clear accountability.

Recommendation.

· Finding #1. BPK recommended that PT Angkasa Pura I (Persero) directors:

(1) impose sanctions on the employee(s) and/or related parties proven to have conducted the tender process and the appointment of the private sector business partner not in accordance with applicable provisions.

(2) reevaluate the determination and appointment of the winning bidders who receive preferential and special treatment.

· Finding #2. SAI recommends that PT Angkasa Pura I (Persero) directors:

(1) perform validity and correctness test of payment proof in accordance with agreement and applicable provisions;

(2) conduct review and evaluation of the agreement in order to provide effective protection for the implementation of the rights and obligations of all parties and provide optimal benefits and reduce the risk of losses for PT Angkasa Pura I (Persero).

CHAPTER 7

PPP PROJECT MANAGEMENT AND AUDIT PRIORITY

Given a sufficient quantity and size of PPP projects, the determination should be made by various government agencies to prioritize the allocation of audit resources for audits. If the goal is one of helping to ensure project success, there are existing models to create public auditor scopes that assist in the internal control process. The timing of such a determination will depend upon national considerations, and in Indonesia’s case, the findings of PPP projects so far indicate that PPP audit priority should be raised.
7.1. Views regarding Contribution of Audit towards better Project Management

BPK has not yet audited the all PPP. Until 2016, BPK has just conducted audits related to PPP projects concerning (1) infrastructure financing and guarantee; and (2) airport management and investment. This is not due to limitations of BPK authority, but rather on resource priorities on auditor personnel, and time in accordance with GOI national development priorities.

Projects undertaken under the existing PPP in Indonesia is a government breakthrough to accelerate development nation-wide especially in the infrastructure sector in order to meet the needs of the community. BPK should play its role in audits of PPP projects in order to help the government and private sector to execute the PPP projects economically, efficiently, and effectively.

7.2. Suggested Improvements PPP Audits

Due to the limitation of BPK resources, the oversight or supervising of PPP projects should expand coordination with other internal audit institutions, such as Indonesia's National Government Internal Auditor (BPKP), and various Ministries’ internal audit departments. Supervision may be in the form of audit, review, evaluation, monitoring, education and training, coaching, or consulting tailored to project needs. With private sector internal auditors playing their role throughout project activities, this element of BPK supervision can be included within the PPP project management system, but consider the following signs:

- Development of PPP projects is almost entirely financed by the private sector, it is necessary for private sector entities to exercise their oversight role by their internal auditor.
- From the beginning planning stage, the role of public auditor supervision in the PPP project should be made clear.
- In principle, supervisory activities can be applied at all stages of project activities: planning, preparation, transaction, project implementation and management. Because all these stages have their own risks and problems, agreement of scope of supervision needs to be formulated at the time of preparation of the agreement / contract.
- The supervisory activities themselves are mainly focused on reducing the likelihood of problems occurring.
- Forms of supervisory activities can avoid a watchdog approach but rather focus cooperatively on coaching, mentoring, coordination, or facilitation, so that a public internal auditor can liaise with project managers while carrying out their work.

Benchmarking to the model developed by South Korea to build maturity within PPP management, the Government of Indonesia can:

- Establish separate authority for policy, contractor / monitoring, and dispute resolution, to prevent conflicts of interest.
· Establish transparent governance structures, with clear responsibilities and competencies.

· Align PPP in governments and agencies throughout the region, and clarifying the responsibilities of different governmental levels of central, provincial and municipal, including the elements of oversight.

7.3. Limitations of the Private Sector Partner in Providing Relevant Auditable Records

Based on BPK authorities as mentioned Law No. 15 Year 2004 Article 10, auditors can request documents or obtain information from third parties related to audit tasks, through audit techniques such as confirmation, inquiry by questionnaire, and interviews. So, there are no significant constraints for auditors to fulfill their need to collect data.

CHAPTER 8
SAI CHALLENGES IN FULFILLING ROLES AND RESPONSIBILITIES IN PPP AUDITS

8.1. Legal Adequacy

Based on a review of literature, the Government of Indonesia via various Ministries has issued comprehensive regulations related to PPP projects as follows:

· Regulation of procurement;

· Public financial management laws detailing institutional responsibilities, processes and regulations.

· Project approval, fiscal limit, budget process, and reporting requirements.

· Sectoral legislative framework recognizes that PPP is different sectors are regulated by different sectoral legislative frameworks. These frameworks may limit the ability of governments to make certain binding contracts with the private sector, or require establishing rules for governments to allow for binding contracts with private parties.

· Other laws affecting the operations of private companies, which also apply to PPP companies, need to be considered when establishing PPP projects and processes. These laws include:
  ✓ Environmental legislation;
  ✓ Legislation governing land acquisition and ownership;
  ✓ Licensing requirements, especially for international companies;
  ✓ Tax rules; and
  ✓ Labor law.
8.2. Capacity Issues

In the above cited PPP audit report on PPP, it was found that several challenges had to be faced by the Auditor, including responses or comments from auditees who disagreed with or rejected certain issues set forth in the audit findings. To argue for and substantiate the audit findings, the Auditor should have an adequate understanding of the PPP business processes, both those of the government and private sector.

BPK is a member of INTOSAI (International Organization of Supreme Audit Institutions) and can access ISSAI material related to PPP audits, namely:

- ISSAI 5210 – Guidelines on Best Practice for the Audit of Privatization
- ISSAI 5220 – Guidelines on Best Practice for the Audit of Public/Private Finance and Concessions
- ISSAI 5230 – Guidelines on Best Practice for the Audit of Economic Regulation
- ISSAI 5240 – Guideline on Best Practice for the Audit of Risk in Public/Private Partnership (PPP).

Currently, BPK has only conducted compliance audits on PPP projects. In order to contribute more broadly to its role, BPK may conduct performance audits to assess whether projects undertaken via the PPP mechanism deliver greater success than projects undertaken by the government itself. Therefore, auditors should improve their capability to perform performance audits efficiently and effectively as PPP projects involve integrating a wide variety of complex business processes.

PPP projects in the infrastructure sector can involve enormous investments, vast areas, and many parties. This is a challenge for auditors to carry out auditing assignments during PPP project implementation. Therefore, the auditor needs comprehensive audit guidance in order to produce a high quality of audit output. Audit guidelines, accordingly, must contain at least the following: (1) an overview of PPP mechanism; (2) institutional arrangement for appraisal and approval of PPP projects; (3) scope and objectives of PPP audit; (4) mandate of PPP audit and accessibility to records; (5) auditing process and criteria of PPP audit; and (6) reporting audit findings and recommendations.

In addition, in the case of compliance audits, auditors need to sharpen their ability to detect fraud at all stages of a PPP project. To that end, auditors should attend fraud-related training or certification such as Certified Fraud Examiner (CFE) or Certified Fraud Auditing (CFrA).

8.3. Difficulties in Interacting with Private Partners

BPK auditors have the authority to audit in the area of states finance, as mentioned in Article 2 Law No. 17 Year 2003. Auditors may face difficulties when collecting documents or information from private parties involved in a PPP project. Some private sector entities may not be aware of the authority of BPK to audit all state financial assets, including those under the management of others. However, BPK has no authority to audit gain access to proprietary information on technology
or other matters, if they are not critical to fulfilling the objectives of the audit. Thus, there needs to be a mechanism by which sufficient data is agreed to be made available previous to the awarding to the PPP project.

CHAPTER 9
OVERALL CONCLUSIONS

Based upon the experience of BPK within Indonesia, the success or failure of the implementation of PPP project is currently the responsibility of various government agencies and private sector entities only. However, involvement from the national external audit institution (SAI) and other governmental internal audit institutions would allocate proven financial oversight resources towards increasing the probability of success.

This expanded role of government by including an SAI and other internal audit institutions would both support private sector auditors and management and reduce the likelihood of mis-allocation or misappropriate of state finances, resulting in better public service delivery and better return on investment. Comprehensive internal control and multi-party oversight can be conducted by all parties through: (1) monitoring and evaluation by government agencies; (2) compliance audits and performance audits by external audit institution (SAI); and (3) supervising and review by other internal audit institutions.

Given a sufficient statutory basis for expanding PPP audits, as exists already in Indonesia, and given sufficient auditor resources, including support through ISSAI and other bilateral and multilateral resources, risk within PPPs can be mitigated and spread so that both private sector and public institutions can gain confidence in pursuing long term and thus high uncertainty projects for the greater public good. This greater public good must be determined on a sector by sector basis, with specific regulatory provisions needed for each, combined with developing the expertise in public audit agencies to become familiar with sector driven complexities.

CHAPTER 10
ACTION PLAN RECOMMENDATIONS

For success of PPP project implementation, the following are the general recommendations based on the existing conditions:

1. BPK and other government internal audit institutions should make arrangements and memorandum of understanding in order to audit, supervise and oversee PPP projects to avoid overlap and to assist the government and private sector entities in realizing the PPP project economically, efficiently and effectively.

2. In order to achieve reasonable quality of a PPP project, BPK should prepare audit guidelines containing at least: (1) an overview of PPP mechanism; (2) institutional arrangement for appraisal and approval of PPP projects; (3) scope and objectives of PPP audits; (4) mandate of PPP audit and accessibility to records; (5) auditing process and criteria of PPP audit; and (6) reporting audit findings and recommendations.
3. BPK should expand the PPP audit types from compliance audit to also performance audit, in order to achieve a higher level of overall PPP audit maturity, from the oversight level to the insight level.

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9. VIETNAM

List of Acronyms

AG : Auditor General
BLT : Build – Lease – Transfer
BOO : Build – Own – Operate
BOT : Build – Operate – Transfer
BT : Build – Transfer
BTL : Build – Transfer – Lease
BTO : Build – Transfer – Operate
MOC : Ministry of Construction
MOT : Ministry of Transportation
MOF : Ministry of Finance
NA : National Assembly
O&M : Operate – Manage
PM : The Prime Minister
PPP : Public – Private Partnership
SAV : State Audit office of Vietnam
SRV : Socialist Republic of Vietnam

Introduction

The 2013 Constitution of Vietnam regulates that the Socialist Republic of Vietnam (SRV) is an independent and sovereign country enjoying unity and integrity of territory, including the mainland, islands, seas and airspace. The Constitution also states that SRV is the country where the People are the masters; all the state power belongs to the People and is based on the alliance of the working class, the peasantry and the intelligentsia. All state agencies coordinate with and control one another in the exercise of the legislative, executive and judicial powers, in which:

1.1. The National Assembly (NA) is the highest representative body of the People and the highest state power body of SRV. NA shall exercise constitutional and legislative powers, decide on important issues for the country, and conduct the supreme oversight over the activities of the State.

1.2. The President is the Head of State and shall represent SRV internally and externally.

1.3. The Government is the highest state administrative body of SRV, shall exercise executive power, and is the executive body of NA. The Government is responsible to NA and shall report on its work to NA, the Standing Committee of NA and the President.

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1.4. The People’s Courts are the judicial bodies of SRV and exercise judicial power. The People’s Procuracies shall exercise the power to prosecute and supervise judicial activities.

1.5. The administrative units of SRV shall be defined as follows. The country shall be divided into provinces and centrally run cities; A province shall be divided into rural districts, towns, and provincial cities; a centrally run city shall be divided into urban districts, rural districts, towns, and equivalent administrative units; A rural district shall be divided into communes and townships; a town or provincial city shall be divided into wards and communes; and an urban district shall be divided into wards. Special administrative-economic units may be established by NA.

1.6. The State Audit office of Vietnam

The State Audit office of Vietnam (SAV) shall be established by NA, operate independently, abide only by the law, and audit the management and use of public finance and assets. The Auditor General (AG) is the head of SAV and shall be elected by NA. AG is responsible, and shall report on audit results and his or her work, to NA. When NA is in recess, he or she is responsible, and shall report on his or her work, to the Standing Committee of NA. The organization and specific tasks and powers of SAV shall be prescribed by a law.

1. PPP Legal Framework


- Mobilizing capital from the private sector, in Vietnam and overseas, for the development of public infrastructure and services; The mobilized capital from private sector shall not increase the amount of public debt; Investors’ equity in the Project must not be lower than 30% the value of capital of private sector. The value of commercial loans (not guaranteed by the Government) must not be higher than 70% of the value of capital of private sector; It operates on the principal of competitiveness, transparency, economic efficiency, in accordance with the Law of Vietnam and international standards and practices.

- Sectors in which PPP projects will be piloted: Road, road bridge, road tunnel, road ferry; Railway, railway bridge, railway tunnel; Urban traffic; Airport, harbor, inland port; Clean water supply system; Power plants; Healthcare sector (hospitals); Environment (waste processing factories); Projects in infrastructure development and other public services decided by the Prime Minister.

- Other regulations: The decree gives instructions on the selection criteria for projects and expenses for preparing investment; it also stipulates which state agencies have the authority to sign and perform project contracts; it also includes regulations on the establishment of interdisciplinary team and the process of conducting bids to select Investors, the negotiation, completion and signing of project contracts.

In accordance with international practices, there are many specific arrangements of PPP, including: Build – Operate – Transfer (BOT) contracts, Build – Transfer – Operate (BTO)
contracts, Build – Transfer (BT) contracts, Build – Own – Operate (BOO) contracts, Build – Transfer – Lease (BTL) contracts, Build – Lease – Transfer (BLT) contracts, Operate – Manage (O&M) contracts. Each type of arrangement suits a specific type of infrastructure or public services.

BT contracts are appropriate for the construction of urban infrastructure or public works while BTL or BLT contracts are used for the construction of offices of state agencies or public administrative units. Meanwhile, BOT or BTO will be selected for the construction of road infrastructure.

- **Institutional Arrangements**

In Vietnam, the three types PPP arrangements are popular, including BOT, BTO and BT arrangements, among which, BOT especially road traffic sector, contracts are the most popular. Sectors in which PPP projects have been undertaken include energy and infrastructure. PPP projects play an important role in the socio-economic development in Vietnam.

The majority of BOT projects are implemented under Decree 87/CP (1993), Decree 77/CP (1997), Decree 62/1998/ND-CP, Decree 78/2007/ND-CP, Decree 108/2009/ND-CP, Decree 71/2010/QD-TTg, Decree no. 15/2015/ND-CP of the Prime Minister. This Decree stipulates that Build-Operate-Transfer contract) means a contract signed between an authorized state agency and (an) investor(s) to build an infrastructure facility; after the completion of the constructed facility, the investor(s) shall have the right to commercially operate such facility for a fixed term; at the end of such term, the investor(s) shall transfer the facility to the authorized state agency.

BOT projects may be invested by investors’ equity or loans; however, the funding proportion must be in accordance with the stipulations in Decree 15/2015/ND-CP regarding the minimum amount of investors’ equity as follows: The investor’s equity ratio must not be lower than 15% of the total investment capital.

Regarding a project with the total investment capital of more than VND 1,500 billion, the equity ratio shall be determined on a progressive basis as follows:

a) For the capital portion of up to VND 1,500 billion, the equity ratio must not be lower than 15% of this portion;

b) For the capital portion of more than VND 1,500 billion, the equity ratio must not be lower than 10% of this portion.

(The State investment capital for participation in the project implementation shall not be counted as part of the total investment capital when identifying the equity ratio).

Not only is equity ratio at a low level (10-15%), loan interests are also counted in total investment capital. Therefore, investors do not have incentive to increase equity but to increase loans, mainly borrowing from commercial banks.

- **Project implementation process**

1. *In terms of approving investment; formulating and publicizing project list*
In accordance with legal regulations on public investment, for BOT projects which use public investment, feasibility study reports must be made for nationally important projects, Group A projects. Investment policies should be made from group B projects and under so that authorized state agencies can appraise and approve the investment. After being approved, the capital contribution of the State in the project will be recognized in the mid-term 5-year public investment plan, the foundation for implementation in subsequent years.

On the other hand, current legal regulations in PPP investment also stipulates on the investment sector, condition and procedures for project implementation, the mechanism for managing and using State investment in the project. Accordingly, ministries and departments at central level, and provincial People’s Committee should formulate project proposals, appraise and approve project list. For projects proposed by investors, projects should also be included in the project list publicized by the authorized state agency.

Therefore, for BOT projects which want to use public capital to for the construction in the project to improve financial efficiency for business projects with capital recovery or building auxiliary constructions, or to compensate land acquisition or land clearance, the investment/project proposal and project list must be publicized in the beginning of the mid-term 5-year public investment plan. The amendment and supplementation to the 5-year mid-term public investment plan is very stringent. These issues are stipulated in the regulations in Law on Public investment, Decree No. 15/2015/ND-CP and documents guiding implementation thereof.

2. In terms of formulating, appraising and approving projects

PPP projects are the form of investment between an authorized state agency and investors or project enterprise to implement, manage and operate the infrastructure facility or public service.

Ministries and departments, provincial People’s Committees organize the appraisal and proposal of projects in Group A, B and C. The procedures and process for formulating, appraising and approving nationally important projects follow legal regulations on public investment.

For projects using State’s investment, basing on the level of capital and estimated source of capital, Ministries and provincial People’s Committee report to authorized state agency in accordance with legal regulations on public investment to make decision before approving.

In terms of investor selection of making feasibility study reports, these must follow regulations on the condition of the operating capacity of individuals and organizations in construction. Contents of the feasibility study reports must comply with the regulations in Article 54 the Law on Construction and Article 25 Decree 15/2015/ND-CP.

For appraisal task, the specialized agency in construction will appraise the baseline design of the feasibility study reports; other contents in feasibility study reports shall be decided by the specialized agency of the organization in charge of investment decision. They will also be appraised by state management agency in
environment, fire prevention and fighting in accordance with relevant legal regulations.

3. Selection of investors

Current regulations on PPP investment stipulate that the selection of BOT investors may be conducted in the form of open bidding or direct appointment. For BOT projects (excluding Group C projects), the investor selection process is as follows: formulating recruitment notice; appraising and approving applications; organizing the preliminary selection; evaluating applications; appraising and approving preliminary result (shortlisted result); formulating, appraising and approving investor selection plan; formulating, appraising and approving bidding documents; providing bidding documents for shortlisted investors; evaluating bid documents, negotiating contract, appraising and approving selection result.

4. Signing investment agreement, registering for investment, establishing project enterprise, signing project contract

The investment agreement is usually signed after investors are selected, which is the basis for preparing application for investment registration certificate (application including: approving decision of investor selection result, investment agreement, preliminary negotiation content, contract drafts). After investment certificate is issued, investors complete procedures to establish the project enterprise. The project enterprise (investors) forms a party to sign project contract with the authorized state agency.

5. In terms of construction management

After the signing of project contracts, select contractors to perform bidding packages in the project, implement technical design, design construction drawing, implement construction, supervise construction, trial, inspect the project construction for operation and exploitation;

- The selection of contractors for the project will be made by investors/project enterprise; this selection does not need to conform to current regulations on bidding. However, investors/project enterprise has to issue consistent regulations for contractor selection for the entire project which ensures fairness, transparency and efficiency.

- The construction process needs to conform to the regulations of the Law on Construction. For the technical design and construction drawing designing process: construction design must conform to: approved feasibility study report, bidding documents, bid documents, project contract, design task, national technical specifications, construction criteria for the project, design content in accordance with legal regulations on construction. The technical design for three-phase design construction, construction drawing design for two-phase design construction, and construction budget estimate must be approved by the designated agency specialized in construction (constructions grade I and above must be appraised by specialized agencies under the Ministries in charge of construction works; constructions grade II and under must be appraised by Departments in charge of construction works).

6. In terms of accounting, auditing and finalizing project constructions

It is stipulated that the authorized state agencies and investors shall agree on the selection of an independent auditing unit to audit the investment capital of the
construction. However, investors shall be responsible for finalizing the investment capital of the construction.

7. In terms of managing, doing businesses and maintaining project constructions

Regulations about the management, doing businesses and maintaining project constructions have been included in the current system of legal documents. Specific contents are included in bidding invitation documents, bid documents and project contracts signed between the authorized state agency and investors.

8. In terms of investment favor and guarantee

Investors and project enterprise implementing BOT projects enjoy favors in terms of business income tax, or receive exemption or reduction in land use levy or rental fee during project duration. When investing in BOT projects, investors and project enterprise can mortgage their assets, land use right and the right to exploit project constructions for business activities on the side of the lender. Written agreements about the price for mortgaging assets, the right to exploit project constructions for business activities must be made between lenders and project contract parties. Land use purposes are also guaranteed for investors and project enterprise during project duration. Public services are provided even when these services are scarce and property ownership is guaranteed.

9. In terms of transferring project constructions

One year before transfer date or during the duration indicated in the project contract, investors and project enterprise must publish a notice on papers about the date for transfer of constructions. It must inform the procedures, deadline for contract liquidation, and payment of debts and must ensure the transferred properties are not used as guarantees for financial obligations or other obligations of investors and project enterprise arising before transfer date, unless otherwise specified in project contract. On the other hand, project enterprise must be responsible for transferring technologies and training and perform periodic maintenance and overhaul to ensure the constructions are in normal operating technical conditions, as required by the project contract.

Authorized state agencies which have the authority to receive the constructions must be responsible for appraising the quality, value and conditions of the construction, as agreed in the project contracts. They must make a list of transferred properties and identify damages (if any) and require enterprises to implement maintenance and correction for the constructions. After being handed over the constructions, the receiving state agencies manage, operate and exploit the constructions in accordance with regulations on public assets.

2. PPP Arrangements

The form of public-private partnership investment has been implemented in Vietnam since 1997. The government issued a Decree on the regulations for investment in the form of Build – Operate – Transfer contracts to create a legal framework to mobilize social resources for infrastructure investment.

Despite the legal foundation, from 1997 to 2005, transportation infrastructure constructions are not attractive enough for investors. There were only a small number of projects applying this model. The reason is because, in the beginning, BOT investment was very novel to investors. This type of investment required a big amount of capital with long
payback period; therefore most investors refused this type of investment, to the extent disbelieving the efficiency of BOT arrangement. In addition, regulations relating to policies for BOT arrangement were incomplete in the beginning and traffic volume was low, leading to a low return rate. These were major hindrances to attracting private enterprises to invest in traffic infrastructure.

During the 2005 – 2010 period, there was more positive signs when more constructions were completed under the BOT investment form such as: Hanoi highway, Binh Trieu bridge, National Highway no.1, National High No. 13 – the section running through Binh Duong province – HCMC City, NH13 crossing Binh Duong province - HCMC, provincial road running through Binh Duong – Binh Phuoc, the section avoiding Vinh City. Especially, since 2011, many modern transportation constructions such as highways connecting Noi Bai – Lao Cai, Ho Chi Minh City – Long Thanh – Dau Giay, Cau Gie - Ninh Binh, Hanoi – Cau Gie … have been implemented from social investment. These constructions have improved the condition of traffic infrastructure.

By now, the Ministry of Transportation has implemented 75 BOT investment projects in road traffic sector. The investment mobilized from the society was at a record high of 68,563 billion Dong in 2013, which was much higher than the years preceding 2012 (49,605 billion dong). In 2014, 42,572 billion dong was mobilized. (This figure is estimated to be more than 45,000 billion dong in 2015, raising the total amount of mobilized capital to be more than 200,000 billion dong).

**Benefits from PPP Projects**

The first benefit is for beneficiaries from BOT projects. Projects funded by social investment in general and BOT transportation projects in particular have brought many benefits to the people and enterprises. The constructions help shorten transportation time of goods and passengers, save energy, reduce cost for maintenance and depreciation. Notably, Noi Bai – Lao Cai, HCMC – Long Thanh – Dau Giay highways have reduced 50% travelling time and 30% of expenses. NH1 from Hanoi to Vinh reduces travelling time and expenses by 30% and 20%, respectively. NH14 reduce travelling time and expenses by 30% and 6%, respectively.

Secondly, for the national socio-economic development, these projects have contributed to bring important and positive changes. Many BOT projects have been exploited effectively and introduced benefits in many aspects, creating the motivation for socio-economic development. They contribute to guarantee national security, reduce environmental pollution, reduce traffic congestion and directly enhance the competitiveness of our national economy. This shows that the competence and quality of Vietnam’s traffic infrastructure have greatly improved.

Thirdly, these projects have helped to reduce the burden on state budget in building infrastructure constructions for the national economy. With 75 BOT transportation projects being implemented or finished, it is estimated that thousands of billion dong (more than 200,000) have been mobilized from different economic elements, reducing the burden on the state budget. This is even more important in the context a high level of budget deficit has existed for many years (5-6% GDP), leading to a direct consequence that public debt is at an alarming rate.

The final benefit is for investors. This is a new investment direction which is quite attractive for investors. Among BOT projects which have been completed and are being
operated, most investors are satisfied with their capital recovery and returns on investment. In some projects, revenue from fees and profits exceed investors’ expectations due to a considerable growth in the number of means of transportation, especially since 2015. In addition, inflation was kept at a low rate (the inflation rate in 2015 was 0.63%; the first half of 2016 saw an inflation rate of 2% and inflation rate of the whole year was expected to be 5%). Therefore, it can be said that in Vietnam there is a booming of BOT investment in traffic.

3. Risks in PPP Projects

The benefits BOT projects bring to traffic infrastructure are significant; however, they also contain some potential risks as follows:

Firstly, legal risks occur when there are changes in the regulations, policies of the Government, local government or authorized Ministries which affect the profitability of PPP projects. Moreover, sometimes management authorities do not have accurate reports of traffic volume, so actual revenue becomes less than expected, which creates many difficulties in recovering investment capital and debt payment plan.

Secondly, some risks occur because the project is behind schedule, which lead to more expenses and difficulties in travelling for people. Below are some main reasons which cause a project to be behind schedule:

The first reason is that the compensation policies for land acquisition are not satisfactory relating to the affected people. Specifically, the compensation prices are inconsistent and not reasonable. People resettle in new areas which are not as good as their previous locations. Staff in charge of land acquisition, such as those consulting and planning land acquisition and those directly in charge of land acquisition are not professional. Sanctions are not synchronous and they are not strong either, therefore, a delay in handing over land to the project. This may be because of the poor management of investors and lack of cooperation between investors and local authorities in conducting land acquisition.

The second reason leading to slow progress is slow disbursement of capital and inefficient capital allocation. The procedures for financing and payment are slow, which lengthen the construction progress. In fact, with the exception of some key projects, most projects have slow progress due to insufficient funding and low payment.

Thirdly, the quality of constructions is low which requires more expenses to improve damages. During construction, there are still many limitations in terms of project management such as: the management of input construction materials used for base structure or road surfaces; the materials and construction quality do not meet technical and technological requirements in accordance with design standard. Therefore, in many locations, asphaltic concrete road surfaces are damaged with signs of cracks and depression. For example, the NH1 project, the route not crossing Bien Hoa city. The project had a total investment of 1,255 billion dong with an expected payback period of more than 22 years. The project was funded by 1,067-billion-dong loan from Vietinbank with a loan period of 14 years. Investors had the right collect toll using Song Phan Toll Plaza (Binh Thuan) to receive return on their investment. However, the road has become damaged, which has not been fixed by investors. Therefore, since 12 pm, May 21st, 2016, Viet Nam Road Administration Inspectorate has demanded the suspension of operation in Song Phan toll plaza. According to calculations, in the first 5 months of operation, the average monthly revenue from toll
fee shall be approximately 15 billion dong. However, toll fee collection being suspended would generate losses on the part of investors, which could be up to many billions dong or more, depending on how long this situation would last.

**Fourthly,** PPP projects also present risks in identifying total investment and final cost. According to current regulations, the Ministry of Construction, total investment can be calculated based on Investment Unit Cost or the figures of similar construction projects; total investment is only the foundation for formulating and balancing capital plan. For BOT projects, total investment is the foundation for the preliminary identification of payback period to negotiation credit contracts and project contracts. To make sure the payback period is accurate and to avoid loss, the Ministry of Construction (with the consultancy from inspecting and auditing agencies) has issued a regulation that the final investment value in the contract will be used as a basis to determine payback period. Calculating total investment of BOT projects must be in accordance with legal regulations. However, during the formulation and appraisal of total investment, there are different interpretations of the Ministry of Construction’s regulations on labor cost, allowance for unstable production, leading to confusion and errors in identifying prices of materials, delivery cost, and volume estimate. Thus there are still confusions and errors in the determination of total investment.

**Fifthly,** these projects harbor some risks due to force majeure events caused by natural conditions, environment, tectonic and hydrologic changes, leading to damages to BOT transportation projects.

There are also potential conflicts between investors and local authorities in areas where the infrastructure constructed. Local areas benefit directly from such projects, and the construction of these facilities shall have direct influences on local socio-economic activities. However, they do not have chances to raise their voices, because projects, by law, belong to investors. Therefore, in local areas where there are long-term socio-economic development plans or those plans have not been approved, investment projects will only take into consideration investors’ benefits. With a lack of comprehensive analysis and evaluation of the impacts that those projects bring to local areas, local areas may face unimaginable consequences from such projects.

Conflicts of interest may also happen between beneficiaries and investors. This is a direct and foreseeable issue which is the most discernible issue of BOT transportation projects. Unfortunately, beneficiaries, including residents and enterprises, are usually at a disadvantage in this kind of conflicts. They may suffer from some problems as follows:

- They do not receive fair compensation when their lands and houses are acquired for the purpose of clearing land for constructions. Many complaints of local people arise from this.

- The tolls are too high, in comparison with the benefits. The roads constructed by BOT projects may save them some time and fuel, but they charge them a much higher cost in the form of tolls. It means they actually gain nothing. In fact, enterprises even face potential losses, because tolls lead to high transportation costs, leading to price increases.

- The high price-setting does not reflect the basic principles of the market economy, which is equivalent exchange and amicable sale. In this regards, investors are price setters and beneficiaries have to accept them. Although some state agencies (Ministry of Finance,
Ministry of Transportation) are assigned the duty of calculating reasonable prices for both parties, in fact, if these agencies act irresponsibly or do not apply scientific and advanced methods to determine an optimum price and reasonable operation time, or if they have other incentives such as gaining group interests or receiving briberies from investors, residents will gain nothing.

- They are forced to use BOT project products. In many BOT projects, the constructed roads are the only option; residents have no choice but to pay the high tolls if they have travel needs. This violates the basic of principle of BOT projects; residents should have choices to use BOT roads or other normal roads, which they pay taxes to build.

- Some residents do not use BOT services but they still have to pay the fees. This is true for residents living along the two sides of the road where toll plazas are located. These people have no requirements to use BOT services, but they still have to pay whenever they pass these plazas.

In short, although BOT arrangement is a new form of investment and business in Vietnam and the world, it has proven many benefits for most subjects in the society. However, it also contains many risks as mentioned above, therefore, a lot of efforts are required from state agencies concerned with BOT investment in particular and PPP investment in general.

4. State Audit office of Vietnam and PPP Arrangements

Article 118 of the Vietnam’s Constitution, amended and supplemented in 2013, stipulates the legal position of SAV as follows:

SAV shall be established by NA, operate independently, abide only by the law, and audit the management and use of public finance and assets.

AGis responsible, and shall report on audit results and his or her work, to NA. When the NAis in recess, he or she is responsible, and shall report on his or her work, to the Standing Committee of NA.

The organization and specific tasks and powers of SAV shall be prescribed by a law.

According to Article 3 of the State Audit Law, which stipulates that both public finance and assets are the objects of SAV, specifically as follows:

Article 3 stipulates that Public finance includes: “State budget, national reserves, state financial fund not included in state budget. Finances of state agencies, People’s Army, public administrative units, service providers, public goods, political organizations, socio-political organizations, social organizations, social-professional societies which use state funds or budget; the state’s portion of capital at enterprises and public debt” and Public assets: “Land, water resources, mineral resources, benefits from coastal areas, space areas, other natural resources, state assets at state agencies, people’s army, public administrative units, political organizations, socio-political organizations, social organizations, social-professional societies; public assets assigned for enterprises to manage and use; the State’s reserved assets, infrastructure assets serving the public benefits and other assets invested by the State and belong to the people, and the State represent to own and manage them”.

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Article 4. Objects of State Audit Office:

“The object of State Audit Office is the management and use of public finance, public assets and related activities to the management and use of public finance and public assets of the audited organizations”.

In addition, Articles 12, 13, 14 of the State Audit Law also stipulates the rights and responsibilities of AG; the rights, responsibilities and legal status of AG are clearly defined to preserve independence and integrity in the auditing activities of SAV.

In accordance with above-mentioned regulations in the articles of the Constitution and the State Audit Law, SAV not only audits the management and use of public finance, but also oversees and evaluates all activities relating to the management and usage of public assets and public finance, whether invested by the private sector or by the state.

PPP is the joint investment of the state and private sector. As the state budget is limited and to mobilize the resources from the economy, the State applies this PPP investment form, in which contracts are signed between an authorized state agency and investors to build infrastructure facilities. Investors are responsible for mobilizing capital and investing in the constructions. Upon completion, investors operate the constructions for a limited period of time, after the contract period, the investor must transfer the construction to the State. Investors may also choose to build infrastructure facilities or public facilities, in exchange the State will return the investment capital to investors (in the form of land or money).

Therefore, as these constructions are also public assets, PPP investment projects must be audited by SAV. Another reason that PPP should be audited by SAV is that, checking and finalizing PPP constructions is essential to determine the amount of tolls and the period of collecting them, which is directly related to the State’s benefit.

PPP investment in general and construction projects in particular comprise three periods, including: project preparation, project implementation and the final operation. The entire process, from preparing investment and investment policies, formulating and appraising projects, opening bids, compensating for land acquisition, compensating contracts and etc., involves the participation of many ministries, departments or provincial People’s Committee. The process is also governed by many regulations in specialized legal documents including the Law on Investment, Law on Land, Law on Procurement.

Depending on the objectives, nature and types of PPP contracts between a state agency (Ministry of Construction, provincial People’s Committee) and investors, the contract parties negotiate all or some basic issues as follows:

a) Objectives, scale, location, time and progress of project; construction time

b) Technical and technological requirements; quality of constructions, products or services;

c) Total investment (including loans from commercial banks and 10-15% of investors’ equity) and project financial plan (financial plans are used to assess the period of time investors operate the constructions to collect tolls);
d) The condition, ratio and progress of disbursement of the State’s investment in the contract (if any);

d) Condition for using land and attached constructions during construction and project exploitation;

e) The responsibilities of compensation, land clearance and resettlement by investors or the State;

g) Organizing construction; monitoring, supervising and managing quality; inspecting and finalizing projects;

h) Appraising, operating, maintaining and operating the project construction; transferring construction;

i) Ensuring labour safety and environmental hygiene during construction and operation time;

k) The conditions and procedures for accepting projects on the part of lenders or banks appointed to participate in the project;

l) Splitting risks between the authorized state agency and investors; force majeures and how to handle them;

m) Forms of favour and investment guarantee (if any);

n) Governing law of the project contracts and relevant contracts; dispute resolution;

o) Validity and term of contracts;

p) Principles and conditions for supplementing, amending or terminating project contract; assigning rights and obligations in project contract;

q) Other contents as agreed between the parties.

Basing on the nature of the Economic contract between the State and Investors, SAV shall audit PPP projects in accordance with regulations of the State Audit Law, and specifications and procedures issued by SAV.

• Types of audit of the State Audit office Vietnam

Financial auditing is conducted to evaluate and confirm the accuracy and reliability of financial reports or financial information of the audited units. Financial auditing focuses on determining whether the audited units prepare their financial reports or financial information in accordance with the regulations on formulating and presenting financial reports and other relevant regulations;

Performance auditing is conducted to assess the economy, efficiencies and effectiveness in managing and using public assets and public finance. Performance auditing considers whether programs, activities, units, public funds, and institutions operate on an economical, efficient and effective principle and whether they will need improvement;
Compliance auditing is implemented to assess and confirm the compliance with laws, rules and regulations on the side of the audited units. Compliance auditing is conducted by evaluating the compliance level of activities, transactions and information, basing on important criteria in accordance with regulations applied for the audited units;

Depending on the nature of audits or at the request of leaders, SAV may conduct separate audits or a combination of the above types of audits.

- **Releasing the Audit report of the State Audit office of Vietnam:**

State specialized auditors or regional state auditors will prepare drafts of Audit reports and present to AG to approve and release the Auditing Report as stipulated.

In accordance with clause 4 Article 55 of the State Audit Law: *The State Audit shall have to send audit reports to the audited unit and relevant agencies, as stipulated by SAV, no later than 45 days, from the date of completion of the audit conducted at the audited unit; in exceptional circumstances, this period may be extended to be not more than 60 days, from the date of completion of the audit conducted at the audited unit;* and Article 56. Making and sending of extraordinary audit reports: *Based on the nature of audits, the State Audit shall make and send extraordinary audit reports to NA, the NA Standing Committee, the Nationality Council, NA’s Committees, the State President, the Government and the Prime Minister.*

Released reports must be approved by units in charge of controlling and appraising audit reports. For drafts of important audit reports, an Auditing Committee is founded by AG to help AG in appraising and issuing the report.

**5. Types of PPP Audit conducted by SAV**

PPP project auditing is a new responsibility of SAV; the responsibilities mainly rest with Specialized Audit Department No. IV (transportation field). The types of audits are mainly compliance auditing, financial auditing and preliminary evaluation of the economy, efficiency and effectiveness of PPP projects.

Within the scope of this research, we only focuses on evaluating Audit Reports of BOT and BT transportation projects implemented by the Specialized Audit Department No. IV during 2013-2016:

We will evaluate the following issues:

1. Types of PPP audits conducted by Specialized Audit Department No. IV;
2. Objectives and focuses of PPP audits;
3. Auditing methods and evidence collection methods;
4. Recommendations to enhance the quality of PPP project management using auditing.

Projects audited by Specialized Audit Department No. IV and issued by AG include:

<table>
<thead>
<tr>
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<th>Description</th>
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<tbody>
<tr>
<td>1</td>
<td>The construction of the route from My Loc town to NH 10, avoiding Nam Dinh city, form of investment: BOT.</td>
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<td>2</td>
<td>The construction of the new Phu Ly – My Loc route, form of investment: BT</td>
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<td>3</td>
<td>Hanoi – Hai Phong highway project</td>
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<tr>
<td>4</td>
<td>The construction of the new Phu Ly – My Loc route, form of investment: BT</td>
</tr>
<tr>
<td>5</td>
<td>The renovation and upgrade of NH 18, from Uong Bi town, Halong City. Form of investment: BOT.</td>
</tr>
<tr>
<td>6</td>
<td>The renovation and upgrade of NH20, from 0+000 - Km 123+105,17 in Dong Nai and Lam Dong province, form of investment: BT</td>
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<tr>
<td>7</td>
<td>The construction of extension of NH1 from Km597+549 - Km605+000 &amp; Km617+000 - Km641+000, Quang Binh province. Form of investment: BOT.</td>
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<tr>
<td>8</td>
<td>The construction of extension of NH1 from Km987÷Km1027, Quang Nam province, Form of investment: BOT.</td>
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<tr>
<td>9</td>
<td>The construction of extension of NH1 from Km947÷Km987, Quang Nam province, Form of investment: BOT.</td>
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<tr>
<td>10</td>
<td>The construction of extension of NH1 from Can Tho – Phung Hiep. Form of investment: BOT</td>
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<tr>
<td>11</td>
<td>The construction of NH1, avoiding Bien Hoa City, Dong Nai province. Form of investment: BOT</td>
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**Objectives, contents and scope of audits**

*Objectives:*

a. Confirm the accuracy and integrity of the Financial reports (sources of capital, investment cost);

b. Evaluate the compliance with laws policies and mechanisms on the management of construction investment and regulations on BOT contracts;

c. Evaluate the economic efficiency in managing and using capital; identify limitations in the mechanism and policies of the state management in BOT projects, basing on which to make recommendations to authorized State agencies for supplementing and amending;

d. Identify violations and request audited units to improve their financial-accounting management, activities and make recommendations to authorized agencies for discipline;
e. Provide reliable information and data to the NA and state management agencies to monitor in the management of BOT projects.

**Auditing contents:**

1. Auditing construction cost, from preparation to final inspection of 100% construction volume, and relating phases before and after.

2. Auditing the compliance with the State’s regulations (finance-accounting mechanism, mechanism for managing the investment and construction)

   2.1. Auditing the compliance with regulations in formulating, appraising and deciding on project investment:

   - The process of formulating, appraising, deciding on investment policies; publishing project list; deciding on the project investment; complying with the decision-making procedures of the project.

   2.2. Auditing project implementation

   - The legal statuses of individuals and organizations in the project;

   - Investor selection; negotiation and signing BOT contracts;

   - The process of surveying, formulating, appraising, approving construction drawings, estimating costs; the relevance between cost estimate, quota, unit price and design.

   - Contractor selection, negotiating and signing contracts;

   - Inspection and payment; Quality assurance;

   - Compliance with the State’s finance and accounting scheme in construction investment;

   - The inspection of constructions for operation and usage; archiving documents.

3. Auditing progress management.

4. Monitoring at site to establish some important indicators in financial plan (traffic volume, operation and management expenses); toll collection plan (locations of toll plazas, reviewing the payback period).

5. Checking the situation of collecting tolls in toll plazas.

6. Monitor and evaluate the implementation of control and supervision functions of the state authorized agencies. Evaluate the economic efficiency and the effectiveness of the Project.

**Scope:**

- Projects are audited since they are first implemented until final inspection, when payment is made for 100% of construction volume for operation.

- Audited objects: Ministry of construction (Project management units) or
provincial People’s Committee in the project; enterprises participating in BOT, BT contracts.

- **Auditing methods in PPP project audits**

  Basic auditing methods: using basic methods in investment project auditing procedures (checking materials, observation, interview, recalculation).

  a. Checking materials related to the authorities and responsibilities in formulating, appraising and approving projects. Procedures relating to bidding, signing contracts; calculating cost of investment;

  b. Checking and re-calculating financial plans (traffic volume, management and operation expenses); toll collection plan (locations of toll plazas, reviewing the payback period);

  c. Hiring an independent unit to consult and assess construction quality; Monitoring construction site (if necessary).

- **Limitations in planning and implementing PPP audits**

  The lack of leading experts in PPP investment means not enough information or wrong information is collected about the audited unit; these risks lead to wrong identification auditing focus and content.

  PPP projects are usually implemented over a long period of time and the management quality of project management units and investors is limited. In addition, there are frequent changes in financial scheme and the management scheme of investment, which leads to difficulties in identifying the content, objective and scope of auditing.

  Audited units (investors) do not cooperate in providing all auditing evidences; conflicts occur frequently during the formulation of PPP auditing reports due to insufficient and incomplete regulations.

  Legal regulations about PPP are insufficient and unclear; auditors do not collect sufficient evidences, therefore their conclusions are unreliable, not persuasive and not feasible. Therefore it is difficult to implement the PPP requests.

  **6. Suggestions of the management PPP projects by SAV**

  From the results 11 PPP projects’ audits conducted by Specialized Audit Department No.IV, on the basis of implementing and simultaneously learning, SAV has supplemented some necessary auditing objectives, contents and methods to ensure resolving limitations in PPP projects, step-by-step enhancing the auditing quality. In addition, there have been reliable evaluation of limitations in each stage of the PPP project implementation process. Basing on these results, recommendations are made to management authorities to perfect policies for the management and implementation of PPP projects. These include:

  Improving the management quality of state authorized agencies. These agencies should be assigned with specific functions and responsibilities. Simply the administrative
Establishing procedures to implement the Investor selection process by procuremen. They should be simplified and their time should be reduced, however, the selection process should ensure the quality of investors selected for the PPP project;

Issuing specific regulations for guiding the formulation of financial plans for PPP projects. The regulations should give specific instructions to make financial plans for PPP projects. The guide should clarify the scientific method to identify economic indicators in the financial plan such as: indicators of growth, indicators of inflation, indicator of investors' profitability, ceiling mobilizing interest to ensure the benefits of both Investor and the State;

Apart from ensuring the legal regulations and protecting the State’s benefit, Investors should also pay attention to social issues which arise in reality such as: traffic volume, environmental pollution, noise; ensuring National security; the minimum spacing between toll plazas; tolls for specific areas.

In addition, from the reality of PPP project auditing, our team also proposes some recommendations to enhance the auditing quality with some internal solutions of SAV. These solutions include:

1. Training new policies about PPP investment; sharing experiences and skills in collecting auditing evidence; providing guidances on career skills and regulations on state audit, regulations on auditing procedures and other regulations relating to PPP project auditing.

2. Building a PPP project auditing process to enhance auditors’ professionalism and efficiencies in their audits, which makes it convenient for the training process to enhance audit quality.

3. Investing in new equipment and machinery to support auditors in monitoring and evaluating construction quality in PPP projects; allocating sufficient funds to hire external experts to assess the quality of constructions and PPP projects when necessary.

• Challenges & Recommendations

Challenges

Policies for PPP projects are incomplete; these policies only focus on the State and investors' benefit. These policies do not govern the impacts of the projects on environment, air, noise and toll amount. Therefore, SAV requires that these policies should be perfected to protect residents’ benefits, those affected by such projects and to enhance the quality of the agencies in charge of PPP projects.

Lacking experts in PPP investment, auditors have to face many new financial plans and they do not share with investors in terms of the risks they have to face in implementing projects. Toll collection plans and growth rate are only estimated. In addition, a legal framework is not issued timely, giving rise to the need for training and experience sharing in new policies in PPP investment. A PPP project auditing procedure should be made; suitable equipment should be provided to support auditors in checking and evaluating the quality of PPP projects;
PPP projects should be audited regularly. This will ensure auditing activities are effective and meet social requirements and to ensure they can meet their missions, which is to make SAV a prestigious and responsible auditing agency.

The lack of cooperation from investors is an obstacle facing SAV. Investors often declare inaccurate figures in terms of the value of the construction and revenues from toll plazas. These are two important and necessary issues which may have great influences on auditing results when it is necessary to identify the operation time of PPP projects.

**Recommendations**

PPP projects auditing has received the attention of SAV, however, these are only the first steps. Currently, SAV has not constructed a procedures for auditing of this type. The auditing results have not meet the demands of management agencies to provide transparent information, avoiding the waste of public assets and to ensure benefits of both parties.

To improve the quality of PPP project auditing, we propose some solutions as follows:

An additional regulation should be made, in which SAV should monitor the revenue of all toll plazas annually to propose the toll and time of business for PPP projects so that the Ministry of Finance can approve and apply for subsequent years;

Assign experienced auditors to survey and make PPP project auditing plans to accurately identify the risks and evaluate PPP project audits. This to ensure an audit plan will be made, which meet all objectives, content, scope and time of audits.

Build and issue a PPP project auditing procedures which match the general procedures of SAV, the auditing standards issued by SAV and the characteristics of PPP projects such as: the ratio of capital contribution of two parties, interest rate, financial plan and risks for two parties.

Train and share experiences with auditors before auditing PPP projects. The training content should focus on the objectives, content and methods of auditing and necessary skills to work with experts under the management of the Ministry of Construction and the Ministry of Planning and Investment (training content includes calculation method in the financial plan such as NPV and IRR... so that auditors can re-calculate the financial plan of the project and identify the period of toll collection).

Auditors should be provided with necessary physical conditions and equipment to assess the quality of constructions. If necessary, they can seek evaluation from a specialized agency independent from management agency and audited unit.

More information should be provided to the residents about the legal status and role of SAV in auditing public assets and finance in general and PPP project auditing in particular. This will ensure management agencies and PPP project investors understand their rights and responsibilities in auditing activities.