

**International Seminar on
Strengthening Public Investment and Managing Fiscal Risks from
Public-Private Partnerships**

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Foreword

1. Tribunal de Contas (TC) is the Portuguese Supreme Audit Institution. TC makes use of several means of control provided by law, in which audits are included, but is also a real court with jurisdictional powers in matters related to financial responsibility.
2. From audit findings, TC makes Recommendations which are mandatory for audited bodies.
3. Most PPP in Portugal were developed without a specific legal framework. This framework appeared only in 2003.
4. TC had been performing audits on PPP long before 2003, and that first legal framework stressed the need to implement measures on subjects that were previously issued by TC in audit conclusions and recommendations.
5. Also, the new legal framework, published in 2006, incorporated measures which, in a large extent, were raised in TC audit reports. The previous role of control was even recognised in the text of the law.
6. The evolution of PPP in Portugal cannot be fully understood without, in this regard, knowing TC audit results. The same is true about what there is still to be done, once new audit findings were recently published.
7. TC developed a methodology for PPP audit, which is currently being updated¹.

A proactive external control

8. PPP are known as complex matters. The simplest part may even be considered tricky. PPP involve interconnected decisions that, in the whole, and in the long run, must not only satisfy public interest, but also, provide balance to the interests directly involved. Formal expression (contracts) must be flexible enough to provide margin for both parties' management, but also strict in order to provide confidence that partners will, in fact, manage the risks the partnership gave them.
9. The complex part may be driven by other subjects. On the first hand, it's good to remind that in the last paragraph we said that the risks were given by the partnership, not by the other part, because perception can be faulty and, in the end, interests may not be aligned.
10. Then, we have to consider that not all risks are controllable, and some that could be, would require economically unviable procedures to put in practice. Also, we must check

¹ **This methodology was developed by senior auditor António Garcia.**

if the PPP configuration is attractive to a partner with, not only adequate general capabilities, but that will also be able to provide effective solutions and a dynamic engagement to endure uncertainty.

11. This is why good planning and monitoring are essential. But, also, we have to ensure that the structures and resources for monitoring and controlling are available from the start or, at least, that they will be, when needed.
12. In such an environment, the way each procedure is conceived and carried out, in order to ensure proper decisions, may not be easily understandable only for itself, in a restrict analysis. In consequence, it seems hard to conceive detailed procedures to lay our hands on, in order to mechanically apply to a specific PPP case, ensuring success.
13. These factors make PPP to require, apart from technical skills, as well as experience based knowledge, and this knowledge to be spread in terms of guidance. By the singularity of each PPP, and because of the need for particular solutions, conceiving a legal framework can be a very delicate subject.
14. On the other hand, to apply management principles, getting a chance to be successful, first we have to remind ourselves, constantly, that PPP are not the only method of procurement, and that it differs a lot from the rest.
15. In Portugal, PPP allowed to put in to service a considerable amount of infrastructures but there has been difficulties in planning, monitoring, and controlling with significant impacts on public expense, many yet undetermined.
16. Aware of these facts, in some cases, from before the first legal framework was conceived, TC² has been able to be a partner in change trough a resolute but gradual approach to the main difficulties put to PPP management.
17. Several critical aspects fall into these categories:

- ✘ Previously to 2003, the need for appropriate framework;
- ✘ The need for appropriate guidance to be issued on specific subjects;
- ✘ Lack of consistent long run budgetary approach;
- ✘ Several fragilities in the public bodies that could potentially become PPP users, which included misperception of PPP philosophy;
- ✘ Lack of control and monitoring leading to an inefficient life cycle management.
- ✘ The temptation to recur to PPP to answer problems placed by conjuncture;

² Trough one of its audit departments, under supervision of Judge Counsellor Carlos Moreno.



Difficulties in articulating effectively the role of all public bodies involved.

18. Audits were made to specific PPP, raising particular risks and trying to answer to its concerns, but always with the larger scope of detecting structural fragilities, that once resolved, could multiply the audit effects.
19. Follow-up audits were, too, very important. They provided the chance to know the state of implementation of previous recommendations, to become sensitive to new critical aspects, and, even, recommend further actions. Not less important is the fact that, some follow-ups integrally transcribe the comments made by the audited bodies, and only then appears TC view of the matter. In the end audited bodies are invited again to state their final opinion, which has been published as an integrant part of the TC report.
20. This provides greater transparency and an opportunity for the public to know the debate that, sometimes, gets close to doctrinal without losing its practical purpose. Another potential effect is making the legislator more aware of the need to legitimate, by law, structural changes in the specific matters reported.
21. As we all know auditors' role is much about managing information. So, if there are audit findings entirely new, others are very close to the melting of a perception that, some how, already existed in the field with, perhaps a broader and systemic view.
22. Relationship with the audited bodies has been determinant to the success of the audits. Though it is our job to manage the risks through audit methods and techniques, the view of people directly involved in operational management is, in the very first approach, considered the best estimator available for characterising risks and possible ways to manage them.
23. All this shows that control was done proactively. Of course, all auditing, namely value for money auditing is inherently proactive. However, in this particular case the adjective is used to stress the awareness of the national stage, as well as the approach developed audit by audit that made possible to magnify the audit findings effects, while achieving critical mass.

Auditing PPP's in TC

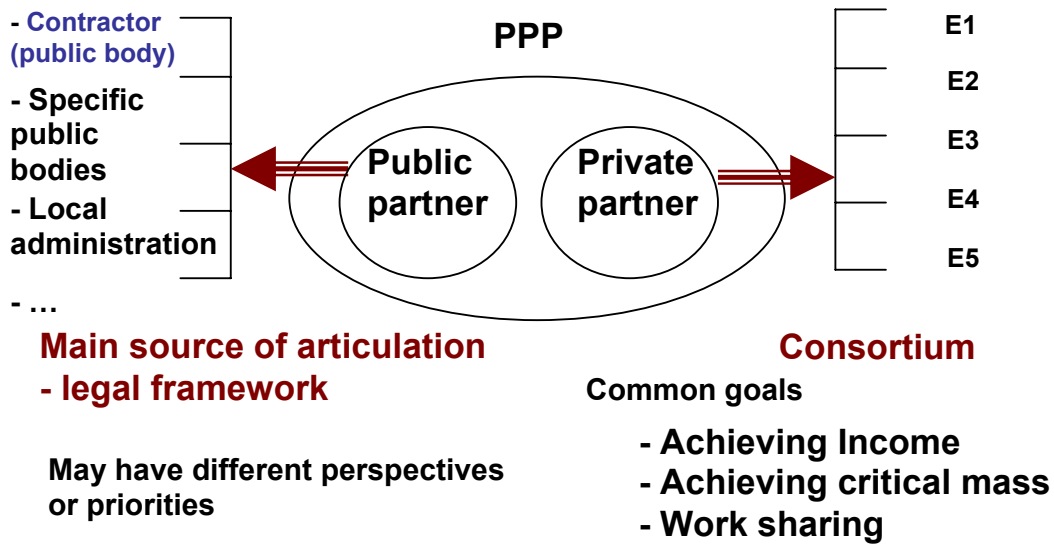
24. In what comes to PPP, TC control is, in short, as follows:

- Contracts come to TC to get a visa;
- National accounts audit (information systems and information itself), collect contributes from several areas of control³, including the contribute of PPP auditing;
- PPP audits are carried - apart from follow-up audits we've mentioned, there can be project audits (only a PPP is audited) and horizontal audits where some transversal management aspects are audited.

³ We must refer that TC gathers and analyses the current budget execution information.

25. Like most Supreme Audit Institutions – SAI, TC uses an own audit methodology for PPP auditing, which, as we said, is currently under revision. This revision is, also, being used as a base a specific audit manual. Audit methodologies for PPP also follow the criteria both of the existent TC audit manual as well as the INTOSAI guidelines.
26. The methodology under revision is presently based on five pillars, so it is called P5:
- **Planning** (support for the decision, ...)
 - **Procurement procedures**
 - **Project** (good deal, quality, price, risks, ...)
 - **Public position** (affordability, risk sharing, control and monitoring systems, ...)
 - **Project performance** (financial and service quality, ...)
27. This methodology structures the audit when only one PPP is involved and, also, in horizontal audits.
28. In both types of audits it is necessary to keep in mind some particularities about the audit environment. In this sense, analysis deal with the distinction of the several frameworks involved.
29. As we all know, at a first glance, in a PPP we can consider the presence of a private and a public partner. In fact, we can also consider that each part has stakeholders.
30. The private partner is most of the times composed of (or detained by) a series of enterprises acting with consortium logic. These stakeholders generally have common goals like achieving income, achieving critical mass, work sharing, ...
31. The public partner can be seen just as the public body acting in the particular PPP as contractor or as the several public bodies and levels of decision involved in the whole management of PPP. Their main source of articulation is generally the PPP specific legal framework.
32. In practice, due to their specific roles in public administration⁴, public bodies may have different goals or at least priorities.
33. The above stated can be represented like in the picture below:

⁴ This is closely linked with some of our comments on discussions that took place in Budapest Seminar, that you can find below.



34. Some examples of the different perspectives involved are:

- Timings** → PPP planning and tendering timings
Vs license or authorisation
- Objectives** → Environment state department/
infrastructure state department /finance
state department
- Procedures** → Most procedures of the public bodies were
Conceived even before PPP appeared
- Decision** → Delays in implementing infrastructures
in urban environment may unbalance central
and local administration powers
- Direct gains or losses** → Few gains –licensing authorities
Full gains – political level and
contracting public bodies
Negotiating – local administration, and
pressure from local populations

35. On the other hand, another inner level of framework, composed by structural factors, knowledge and management needs, can be skimmed.

36. In this level we can recognize, or not the existence of: excellence centres in PPP (near the main departments that are PPP users); quality of the information used for management (sources and information used to base decisions); quality of the methodologies used, distinguishing those which are based on mandatory rules and those which are issued only in terms of guidance; adequacy of the standardization of documents and procedures; adequacy of control definition, mechanisms, procedures,

resources and structures; quality of planning; financial information and perspectives of financial forecasting as well as sustainability.

37. Only through a very structured analysis, made possible with a proper methodology (in our case, for the time being, P5) as well as the knowledge of the audit environment, SAI (in our case, TC) can make themselves aware of the national stage on PPP management, preliminarily identify risks, and build up and a feasible control strategy capable of providing relevant audit findings.

Some notes about the Budapest Seminar

38. We think that a reflection must be done not just only about the new information gathered, but also about the best way to assimilate it.
39. Although the following matters were already presented in Budapest, prior to the ones referred above, these notes resulted, also, from a reflection done, back in Lisbon, inside our Department, with the sole intention of providing ground for further discussion. So, it is intended to present what can only be considered as leads for discussion.
40. We've tried an approach which may, eventually, be useful both for participants and for sponsoring organizations
41. Though we are forced by our activity to be up-to-date in terms of what is happening elsewhere on the PPP subject, events like this seminar, play an irreplaceable role, once they allow us not only to acquire valuable information, but also to weight it according to the sensibility to the subjects presented by the sources themselves.
42. Not only were the contents and form of the presentations very good but the several approaches chosen by the speakers, resulted, also, in the whole, in a very good ground to reflect upon. To prove this, is the fact that during the entire seminar, including the breaks, many questions were raised and the exchange of points of view and information was constant. We think that diversity was a huge plus in this extremely well organized seminar.
43. As perhaps some of us can recall, during one of the sessions, one colleague from the audience remarked that all countries (more and less PPP users) have problems to solve about PPP. Portugal is, somehow, in the middle term, not only because is part of the European Union for some years now (and the impact trough the years have been, in several areas, very important), but also because if we have been using PPP while making efforts to improve public administration.
44. In our opinion, this environment turned possible to perceive that even if a clear distinction can be made, between the approaches of the PPP user countries and the PPP less user countries, some points of view in specific matters are similar, although for different reasons.
45. It seems that, apart the influence of other political and cultural aspects, some important aspects may be, in short:

- The level of development achieved in alternative types of procurement (not only in terms of effectiveness but, also, in terms of the information made available to manage risks);
- The perceived role of public administration as well as the contribution of intermediate public service objectives to a broader sense of public service. In what concerns this, it seems that most public administration (indistinctly) structurally give more importance to the achieving of intermediate objectives, important to public administrations' activity, but that, sometimes, in the long run, can be an obstacle to public service provision. In our opinion, apart, from the benefits of private management, PPP introduce stronger demandings in public management, once they stress the need for an effective articulation of intermediate objectives in the long run.

46. So, during sessions and breaks we think it was possible to identify some subjects sensitive to participants, from which we've chosen the following (their persistence may induce a certain resistance to PPP or, at least, a worst risk management, in our perspective):

a. The notion of sustainability

- There is a general concern about sustainability. In practice, when applied to PPP, we think the concept is often diffuse, once it is used without further considerations about conditionings such as specific macro economic conditions or public service objectives to be pursued.
- Anyhow we must agree that there must be a certain level of concern in this point and objective and effective control instruments must be achieved, mostly in the field of controlling spending commitments for the years to come.
- The same precaution principle applied to annual budget must be present too in long term commitments scheduling.
- Presently, even if we speak about the same type of PPP commitments scheduling control, there seems to be a lack of consensus about the parameters to use (if identified). The most common approach is to compare annual budget expenses with future PPP commitments. Once we are comparing two instruments of different nature (in what matters now, annual and long run), it is not possible, from the start to obtain good estimators and we obtain a biased analysis.
- We can consider another source of bias. The concept of budgeting, and expense, may not be enough to evaluate financial sustainability. In fact, in the long run, financial sustainability and service provision cannot be considered apart. In what concerns any type of procurement, in the most common approach - impact on budget expenses – it is only considered the period in which payments are foreseen, but projects or assets life terms, operation and maintenance costs, reposition investment and consequently service provision periods are not taken into account.
- Consequently, also, in the long run, looking for a “morbid” sustainability (this is, sacrificing public service provision, out of

objective structural and conjunctural situations which would impose it) is by nature incompatible with the option for PPP.

- An unreasonable concern about sustainability may lead, from the start, to the wrong choice of investment projects or programs. One alternative limit project, always present, is no project at all (otiose option).
- In most relevant cases, in a preliminary evaluation, perhaps we would find the otiose option as having a negative present value or a low present value. In fact, apart from political reasons, this should be one of the best reasons for public investments to be put into agenda (or not). The definitive choice of a procurement method would come next (PPP or other).
- Annual budget is often considered as the main instrument of political control of Government activity. So, also at this level, there may be problems in assuring a long term commitment. In our point of view, a proper legal framework for PPP mitigates this problem. Legal framework may provide procedures that enables track records of the decision process and it's support, as well as conditions for technical appraisal, namely about financial impacts (and even if sometimes information is imperfect).
- Even with all referred constraints, sustainability is often evaluated only in terms of future expense (expense commitments, mostly the ones to be paid to the private partner).
- Also option appraisal and valuation, if done for project decision, may have, in practice (although they should) no consequences in terms of evaluating sustainability (this is, for instance, apart from generating expense, a PPP project may result, from the start, in the loss of State revenue if the service provided was, or is to be, paid for directly by citizens).
- Continuing in the field of option appraisal, financial side effects of PPP projects, on other projects in which state is involved, may not be taken into account or just not valued. These may have impact both in revenue and expense.
- Also, very often, risks that are attributed by the partnership to the public partner may have no valuation in the forecasted financial amounts (many examples can be given: necessary land expropriation expenses; expenses with control and monitoring structures and operation,).

b. The notion of public service

- Before choosing any procurement method, we must take into account the desired public service to be provided. In state (direct or indirect) projects initial notion of public service can, on the way, be lost. The reason is that for public administration bodies intermediate or instrumental objectives are far more important (budget control, infrastructure development, environmental protection, ...). It is still much around annual state budget that public administration activity organizes itself and establishes priorities. Sometimes, this short term vision tends to be far from the service to provide.

- Even more than different notions of public service, there can be differences about the public service national concepts. For instance, it may be relevant to distinguish if and how public service can be provided by other than state public institutions.

c. The visibility of risks

- Our opinion is that, nowadays, there are difficulties about long term planning in any kind of procurement. In procurement methods alternative to PPP, risks that are more easily foreseen are those related to under or over capacity. The quality of service is often assumed constant over time. The PPP life cycle management optic may introduce, from the start, the considering of multiple interconnected aspects and, so, a much more visibility of a large number of risks.
- We must, also, keep in mind that as we start to perceive more potential benefits, or we perceive the benefits as more important, the more we are aware of the risks involved. This risk awareness may make us substantially more concerned about control and monitoring.
- In other words, the absence of benefits consideration may be a major risk, once it induces bad contractual arrangements and the absence of monitoring and, for instance, better service or additional revenues.
- PPP developed within a proper framework are, generally, more demanding methods of procurement. They are able to generate not only more information, but also information that can be improvable over time. For this reason, perhaps some concern derives from the (more) visibility of the risks involved.
- In the same regard, in the efforts to adapt existing control and monitoring systems and structures, PPP often make more visible the previous deficiencies in control and monitoring structures, as well as in the methodologies that were used.
- Unsustainability, that we mentioned earlier, is a major risk that, in most cases, is more visible in PPP than in other methods of procurement. In fact, among us, few are the public procurement methods, providing information in the long run, as PPP do. For the reasons stated above, unsustainability may not be greater in PPP, but only a more visible risk.
- In other procurement methods several sources of potential unsustainability can be recognized. However, very often they are not considered, particularly in the long run. Investment projects can be dispersed through the whole budget without the identifiable need to present information about future commitments on budget report (the introduction of PPP were, in fact, responsible for a new demanding attitude in order to recognize PPP specific expenses in current public accounting). Many public long run investment programs (20-30 years), didn't, in fact, included all expenses with operation and maintenance and sometimes when they did it was just not clear if those expenses could be attributed to that specific program, just because heavy information systems used by public administration were not comfortable with exceptional needs of information.

Traditionally, public investments programs commitments are scheduled according to the periods in which payments happen, and there is no necessary coincidence with assets life cycle. In the long run assets become, more or less quickly, obsolete, so, sometimes, payments will still occur for some years on. In those cases, in a substantial part of the final years new expenses will surely cumulate with the ones foreseen (visible) in the beginning.

d. PPP notion

- By PPP we can understand different realities. For a start, European Union distinguishes institutional from contractual partnerships. A description of several types PPP can be consulted in INTOSAI guidelines.
- Not all countries in their national legal frameworks recognise PPP as including all categories described by those guidelines. For instance, in Portugal, concession contracts are just one of the several juridical instruments possible to use in PPP. Nevertheless, not all concession contracts can be considered PPP.
- There can be, also a question of scale, namely financial. So, legal frameworks can apply according to the values involved.
- Of course there are, also, other parameters which can be considered in legal frameworks such as the type of service to provide, and the public bodies entering as contractors, among others.

e. Hierarchy of priorities, when recurring to PPP contracts

- This subject is close to the above one, “PPP notion”. It seemed to us that the concept of PPP, at least as we understand it, was not immediately recognised by all participants.
- Apparently, though knowing for sure the whole concept, some participants may value only a fragment of it. This seemed to happen even with more experienced countries.
- Some aspects in which this fact reflects are:
 - The objective of PPP as procurement method, sometimes referred as acquiring infrastructures at the lowest price or overcoming budget constraints;
 - Little or no reference to quality concerns;
 - Reference to transferring to the private partner as much risks as possible;
 - Little emphasis on the potential of creativity and innovation of the private partner as well incentive solutions to be put in practice by the public partner.
- Two immediate possible causes could be the public body of administration of origin for the participants (see, above, “The notion of public service”), or the different cases of reference to each one (INTOSAI guidelines referred in “PPP notion”).
- Or the other hand, if in the case of less experienced countries no demonstration has to be made, in the case of more experienced countries the explanation may lay in the effectiveness achieved in

alternative methods of procurement, making less visible the distinction of PPP potential.

f. The role of external control (by a Supreme Audit Institution - SAI)

- As we all know, there can be different configurations of SAI. Among other reasons configurations are determined by the powers attributed, constitutional functions, place in the state hierarchy and characteristics through which independence can be ensured.
- It is not uncommon to associate SAI only to the idea of financial audit. Former institutions, upon which SAI were built, carried away, essentially, such kind of control. On the other hand, as referred before, public administration activity is still very much marked by the annual budget cycle.
- However there has been a growing emphasis on controlling economy, efficiency and effectiveness, through operational or value for money audits.
- At the same time SAI control have been adapting to the needs placed by new ways of governance, namely indirect ones.
- Legal aspects and more direct financial aspects must be objects of control, but the effectiveness of the existent rules (whatever their support may be) must be analysed as they are, also, instruments of public management, which objectives must be clearly stated. In this regard, audit findings become relevant whether they stress positive or negative aspects of management.
- Control of political objectives is out of the SAI range of functions and belongs to parliaments as well as to citizens directly.

g. The role of methodologies

- Many participants referred methodologies as important.
- In general terms, audit and management methodologies can be considered two faces of the same coin, though they may have different ways and needs to be put in practice.
- In that regard we recommend the reading of INTOSAI guidelines.

This paper was not previously submitted to Court's approval and, therefore, contents are my full responsibility.

Francisco Machado
Lisbon, March 30, 2007

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