Office of the Comptroller and Auditor General of India

Professional Practices Group

Guidance Note

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To

All Heads of Field Audit Offices

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Subject: Compliance audit of Public Private Partnership arrangements

Public Private Partnership models have been extensively employed in infrastructure sector, which include Transport, Energy, Water Sanitation, Social and Commercial infrastructure. In addition, with the evolving governance structure, the nation's wealth/natural resources are also being dealt by private parties for delivery of public goods and services. Since these PPP arrangements/structures along with the governmental organisational hierarchies implement government policies, receive, collect or expend public money these collectively comprise our audit universe. The Public Auditing Guidelines for Public Private Partnerships (PPP) in Infrastructure Projects brought out by the Department in 2009 essentially relate to performance audit of PPP arrangements.

Given the proliferation of PPP arrangements and their growing significance, the compliance audit of PPP arrangements needs to be strengthened. The objective of this guidance note is, therefore, to mainstream the planning and conduct of compliance audits of these PPP arrangements on a regular basis.

2. Salient features of the Compliance Auditing Guidelines

The Department has adopted the Compliance Auditing Guidelines envisaging a risk based approach to compliance audit, which requires preparation of annual compliance audit plans by:

a) defining the Apex Auditable Entities and Audit Units and distinguishing them from the Implementing Units and

b) risk profiling for their risk based selection for compliance audits.

The Compliance Auditing Guidelines provide the broad dimensions for evaluation of the high risk areas as also the various documents/literature and aspects that should be reviewed for assessment of risk. **Based on such a risk assessment the field offices have to prepare the annual compliance audit plan comprising a selection of Apex Auditable Entities and of Audit Units as also a sample of PPP arrangements as considered appropriate.** The need for accessing the records of the private sector would have to be determined by the controlling DAI/ADAI, on a case to case basis, depending upon the risk assessment of the subject matter and the ability/inability of the CAG to effectively fulfil its mandate only through the records of the government/public entity. The protocol for accessing the records of the private parties has already been prescribed in the guidance note issued vide No. 119/3-PPG/2014 dated4 July 2014.

3. A guideline for compliance audit of PPP arrangements comprising a) a fact sheet for maintaining database of PPP arrangements, b) indicative risk parameters and (c) indicative checklist for audit of PPP arrangements has been prepared to facilitate risk assessment and conduct of regular compliance audit of PPP arrangements by field offices. The guideline is enclosed. This guidance would be supplementary to the Public Auditing Guidelines for Public Private Partnerships (PPP) in Infrastructure Projects, 2009.

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No. 727 **16-PPG/2016 dated** : 24.8.16

Copy to:

(i) All ADAIs/DAIs
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GUIDELINE FOR COMPLIANCE AUDIT OF PPP ARRANGEMENTS

Audit of PPP arrangements had been a focus area of concern as this involves access to the records of private parties. Hon'ble Supreme Court, in its judgement[1] dated 17 April 2014, has allowed audit access to records of the private concessionaire in revenue share contracts to ensure that there is no 'unlawful gain' to the private concessionaire and no 'unlawful loss' to the Government/ public entity. This has expanded the audit access and the PPG group has issued a guidance note (4 July 2014) which lays down the audit protocol in such cases of revenue share PPP arrangements where the records of the private partner can be directly accessed. The earlier guidelines issued in 2009 dealt with performance audits of PPPs in infrastructure projects. Given the proliferation of PPP arrangements, their high materiality and significance, the audit of PPP arrangements needs to be mainstreamed as a part of compliance audits.

2. Scope of the guideline

This Guideline draws attention to the following:

a) Audit of PPP projects should be taken up as per the mandate provided under the Supreme Court judgment.

b) Audit of PPP projects should be mainstreamed and included as a component of regular audits.

c) Audit should develop capacity and build specialisation in audit of PPP arrangements.

3. PPP models employed in different sectors

PPP models have been extensively employed in infrastructure sector in the country. These PPP infrastructure projects includes Transport, Energy, Water, Sanitation and Social & Commercial infrastructure. 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. In the ten rounds of NELP (New Exploration Licensing Policy), 254 exploration blocks have been awarded resulting in an investment of over 23 billion USD (till June 2006) in exploration and development activities. 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. Existing guidance and audit experience

4.1 In 2009, the Department brought out guidelines for auditing public private partnerships in infrastructure projects. The guidance have been effectively used to plan, conduct and report upon performance audits of PPP projects. Performance audits of spectrum and coal block

[1] Association of Unified Tele Services Providers & Others vs. Union of India

allocation, development of brownfield airports in Delhi and Mumbai, development and maintenance of national highways, implementation of hydrocarbon production sharing contracts have been successfully attempted.

4.2 The Supreme Court judgment (17 April 2014), has allowed audit access to records of the private concessionaire in revenue share contracts to ensure that there is no 'unlawful gain' to the private concessionaire and no 'unlawful loss' to the Government/ public entity. This has expanded the audit access and the PPG group has issued a guidance note (4 July 2014) which lays down the audit protocol in such cases of revenue share PPP arrangements where the records of the private partner can be directly accessed.

5. Strengthening and mainstreaming audit of PPP arrangements

5.1 PPP arrangements in India follow various models and there are sector specific subtleties to these arrangements. Broadly, though, considering the financial interests of the Government/ public partner, there could be two distinct kinds of PPP arrangements:

- Arrangements which generate revenues for Government or the public partner; and
- Arrangements which are either neutral or involve expenditures from Government on account of Viability Gap Funding (VGF) or annuity.

5.2 In audit of both arrangements, the records of the public partner (Government/ public authority) are available for audit scrutiny. For revenue share contracts, however, the recent Supreme Court judgment has provided access to records of the private partner also which expands the scope and extent of audit. It is felt that a set of risk factors and audit checklist would be of practical assistance for actual conduct of audit of revenue share contracts.

5.3 The earlier guidelines (2009) dealt with performance audits of PPPs in infrastructure projects. Given the proliferation of PPP arrangements, their high materiality and significance, it is suggested that audit of PPP arrangements be mainstreamed as a part of compliance audits. This would not only increase audit coverage of PPP projects and improve timeliness of audit. the regular audits could throw up irregularities in a sector or programme which could be more comprehensively studied later through detailed performance audits.

5.4 To facilitate regular audits and focus on revenue share arrangements, the following is recommended:

- **Uniform database:** Each office may maintain an up to date database of PPP projects which would enable selection of a sample of such projects during regular audit of the public partner (Government department/ public entity). An indicative uniform format for the creation of such a database is enclosed at ***Annex-I***. The field offices may device a mechanism for obtaining the details of PPP arrangements regularly so that the uniform database can be maintained and updated regularly. In case of State audits, these

arrangements should be reviewed either in the Financial Attest Audit wing or by the wing concerned. The fact sheet would provide particulars of the project, the model of PPP employed and the key parameters of the project (total project cost and concession period). It also provides an indication of the project status including expenditure incurred or revenue received by the public entity on the project. Additional information for revenue share contracts (total revenue earned, sources of revenue, revenue share model, changes in the revenue trend) have been built in the suggested database.

- **Risk factors:** A set of indicative risk factors for PPP arrangements is at ***Annex-II*** with focus on revenue share arrangements in particular. These indicative risk parameters may assist the audit office to select a sample of PPP projects for detailed scrutiny during regular audit.

- **Checklist for audit:** A simplified audit checklist covering planning, selection of concessionaire and the implementation of the concession arrangement for use in compliance audits of PPP arrangements is at ***Annex-III***. Specific checks for revenue share arrangements have been highlighted in the checklist.

6. Access to records of private entities for PPP audit

PPP arrangements have two partners, the private sector partner and the public entity. While the records of the public partner can be audited in the normal course, the need to access the records of the private partner would have to be determined. The decision to access the records of the private sector partner has to be taken with the approval of the controlling DAI/ADAI, on a case to case basis, depending upon the risk assessment of the subject matter and the ability/inability of the CAG to effectively fulfil its mandate only through the records of the government/public entity. A guidance note prescribing the protocol for accessing the records of the private sector issued vide communication No. 119/3-PPG/2014 dated 04.07.2014 by Professional Practices Group may be referred to in this regard.

7. Capacity Building

Considering that PPP arrangements are often long term contracts with high degree of complexity, there is a need for developing capacity and specialisation in the area at Headquarters as well as field offices. Along with traditional expertise of contract audit, an in-depth sector specific knowledge, understanding of information systems and ability to audit through such systems and an appreciation of legal provisions would be desirable for PPP audit.

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Annex – I

Fact Sheet of Public-Private Partnership (PPP) projects as on …

Sector:
Policy/ Programme/ Scheme:
State:

Sr. No.	Particulars
PROJECT DETAILS	
1	Project Title
2	Project Details: - Administrative Ministry/ Department - Name of Sponsoring Authority (public partner) - Name of Implementing Agency (private partner) - Location (State/ District/ Town) - Brief description of the project
3	Mode of PPP: - Revenue share arrangements - BOT (Build, Operate and Transfer) - BOOT (Build, Own, Operate and Transfer) - LOT (Lease, Operate and Transfer) - Operations Concessions - DBFO/DBFOM (Design, Build, Finance, Operate and Management) - Joint Venture - Other Type (please, specify)
4	Total Project cost
5	Concession period including possible renewals
6	Specification of standards and quality norms to be delivered
7	Project Status (As on …): - Selection of private partner and signing of contract - Under construction - Under maintenance and operation
SELECTION OF PRIVATE PARTNER	
8	Basis of Selection of Private Party: - Domestic Competitive Bidding - International Competitive Bidding - Negotiated MOU - Unsolicited Offer
9	Bidding Parameters -Viability Gap Funding (VGF) -Premium -Annuity payment -Profit share, revenue share
10	Private partner/ consortium selected
11	SPV details: - JV incorporated along with share (If so, date of incorporation) - JV un-incorporated (If so, date of MOU or Other arrangement)

	- Other form (please specify, if any)
12	Public investment in SPV (as on …): - Shareholding pattern of SPV indicating ownership of all parties (Rs. in crore and percentage) - Public equity Investment in SPV through Subsidiary (Rs. in crore) - Non-cash investments, if any
PROJECT UNDER EXECUTION	
13	Pattern of funding -Equity by the Concessionaire -Long term debt -Share of public partner
14	Responsibilities remaining with public partner -provision of land -environmental and other clearances -expenditure made or committed (VGF, annuity etc.) -Tax benefit, if any, provided by the Government for the project -Others (e.g., guarantee provided)
15	Expenditure incurred by public partner as on …. Revenue received by public partner as on …
16	For revenue share contracts: -Total revenue earned by private partner (for the past five years) -Sources of revenue earning - Model of revenue share with public partner (profit share, revenue share, etc.) - Whether the revenues are deposited in the Consolidated Fund of the Union/ States as per the agreement/ contract
17	Details of Escrow Accounts, if any.
MONITORING AND AUDIT	
18	Reporting requirements and their compliance as on… - Independent Auditor (IA) reports - Independent Engineer (IE) reports - Action taken on IA and IE reports
19	Audit arrangements, in particular provision for audit by CAG

Annex-II

Indicative risk parameters in PPP projects

Risk parameter	Assessment
Total project cost	- Higher project cost indicates higher significance
Concession period	- Higher period associated with higher risk - Possibilities of renewal also enhances risk
Projects involving expenditure by public partner: - VGF paid - Annuity liability assumed	- Higher VGF payment or annuity liability would indicate a higher materiality for public audit
Projects involving revenue share - Overall revenue earned in the project - Diversity in sources of revenue and related party sources of revenue - Complexity of the revenue share arrangement - Changes in the revenue shared with public partner	- Higher the revenue earned, higher the materiality for public audit - Higher diversity in sources of revenue, related party sources, increase the risk of completeness of revenue - Greater the number of adjustments, more complicated the sharing model, higher the risk - Decrease in revenue share of the public partner may be indicative of higher risk for the public auditor
Projects involving lower share of equity investment by the private partner	- The finance risk is not adequately shared by the private partner and if public share is comparable or higher, may indicate a higher risk for public audit
Projects involving significant guarantees and residual liabilities of the public partner	- Higher assumption of guarantees on revenue or other liabilities would indicate a higher risk for the public auditor
Specification of standard and quality norms	- In case the standards, service levels/ quality are clearly indicated in the arrangement, the risk is lower
Monitoring action of public partner	- Availability of regular IA and IE reports and persistent action on these reports lowers the risk
Audit coverage in the last five years	- If the PPP arrangement has been audited in the last five years without any significant observations, the risk is lower
Subsequent changes in the terms of the agreement or termination	- This indicates a higher risk to the public auditor
Implementation and contract management	- Establishment of a dedicated contract management team to monitor performance and approve payments would indicate lower risk - Lower capital at risk or easy exit options for the concessionaire suggests greater risk - Modifications/ variations to the contract implies greater risk - Fulfilment of conditions precedent by the transaction parties suggests lower risk

Adverse media reports/ Parliament questions/ complaints received	- Indicates a higher risk of the project
Arbitration/ litigation resulting from the PPP arrangement	- May indicate higher risk

Annex-III

Indicative checklist for audit of PPP arrangements

Description	Audit examination
Planning PPP projects	
Plan, appraisal & approval	1. To check whether the project is a part of larger programme, long term plan or policy and is it in line with the approved parameters of such programme, plan or policy. Also whether the need for the project is clearly articulated and the project is justified when it is selected among many competing projects in terms of financial cost, selection of location. 2. To study the Detailed Project Report and Feasibility Report of the project to assess *(in case of projects where it is available)* (a) The reasonableness of the assumptions made regarding the key parameters (eg., project cost, concession period, user charges, demand of the service). (b) In particular, the project cost may be scrutinised to check whether it has been overstated (through over-engineering or otherwise) to enable a higher VGF. (c) The PPP model chosen is the appropriate one based on the project parameters and has been justified as the most suitable option. (d) In case of annuity projects, may need closer scrutiny to check the rate of return in-built in the annuity payment to concessionaire. (e) That the expected outputs of the project were clearly defined along with well-defined, enforceable, standards of operation and maintenance along with specific penalties for their violation. 3. To check whether the laid down appraisal and approval processes have been followed. In particular to check whether the concerns expressed by the appraisal agencies have been addressed and the assurances given by the project authority have been fulfilled before final approval is taken. These issues could also be checked vis-à-vis the actual position during implementation stage. 4. To check the budget and fund availability of the public partner in case VGF or annuity mode is chosen.
Selection of concessionaire	
Tendering, contracting	(a) To check whether appropriate tendering processes were followed by the public authority focussing on the following aspects:

	(b) The RFQ (request for qualifications) and RFP (request for proposals) issued are in line with the standard approved documents and deviations are adequately justified. (c) That maximum competition is ensured throughout the tender process needs to be checked w.r.t. CVC guidelines. Competition could be checked by including un-reasonably restrictive criteria for participation, un-realistic timeframe for response, lack of information and publicity regarding the project, etc. (d) In case a consultant has been appointed for supporting the bidding process, it needs to be checked that the consultant has been competitively selected and the terms of agreement with the consultant is in line with the model agreements available in this regard. The aspect of conflict of interest of the consultant will also need to be checked in audit. (e) Whether the bids have been evaluated in an impartial and objective manner and whether the winning bidder satisfies all technical and financial qualifications for the project needs to be checked. It also needs to be checked that all bidders have abided by the bid conditions. (f) In case of pre-bid conferences and any change in the tender document or additional support allowed by the public partner (eg. mobilisation advance), the implications needs to be scrutinised. (g) The winning bidder complied with all terms and conditions and offered the best bid as per the bidding parameter. (h) In case of participation of consortia in the contract, the legality of the consortium, competence and willingness of the parties etc. may be checked (i) The contract entered with the winning bidder is in line with the model concession agreement. In case of any deviation, audit must check that adequate justification and approval of the competent authority exists for such departure. (j) Whether the contract has adequate safeguards and penal provisions to deal with defaults of the concessionaire
Implementation of the project	
Conditions precedent	Identify and list out the conditions precedent to be fulfilled by the sponsoring entity (eg., land acquisition, environmental clearance, etc.) as also the Concessionaire (performance guarantee etc.) as per the transaction Documents/ Concession Agreement. To verify that the transacting parties fulfilled their obligations by the due dates. The impact of delay on the project completion to be assessed.

Capital at risk for the private partner	To verify that the private partner has sufficient capital at risk so that exit becomes an expensive proposition. This is necessary as Government assumes a set of implicit guarantees in PPP projects of taking over the debt in case the private partner fails or goes bankrupt. Other instruments that could bind the private partner: • a materially large performance bond to cover the period between acceptance of a bid and significant capital expenditure by the Private Party on the project • a sizeable performance bond or warranty towards the end of the contract.
Approvals	To verify that necessary permits, authorisations and approvals required prior to the start of construction were obtained in a timely fashion. In case of failure, the party responsible needs to be identified and the impact assessed. Timely land acquisition, environmental clearance, external linkages are essential pre-requisites for completion of the project on time. Delays should be commented on along with responsibility for such delays and assessment of their impact.
Financial Closure	To verify whether the financial closure of the project was achieved on time (as per timeline specified in the agreement). In case of delays, its impact on the project in terms of time and cost to be assessed. The action taken by the project authority in such cases should be scrutinised to check whether action has been taken against the concessionaire as per the terms of the contract and penalty levied, if any.
Cost of Capital	Verify that the cost of capital required to fund the project has been correctly worked out and is close to the average cost of capital of the entity that owns the project. Verify that the debt equity ratio maintained as per approved project cost and bank loan sanctioned and drawn are as per approved project cost and milestone achieved.
Adequacy of Planning	To verify whether the work progressed as per plan. In case of deviations, the reasons for the same to be identified and checked against the premises assumed at the planning stage. The actual project design and project cost should also be checked vis-à-vis planned. In case of deviations, the reasons should be scrutinised and checked whether these were reasonably justified.
Time and Cost over-run in construction	To examine that the construction of the assets required for the project was completed on time, budget and to specification. The reports of the IA and IE would be useful for such assessment.

	The impact of time and cost over-runs to be scrutinised and commented. The risk of increasing costs may not be absorbed by the concessionaire and may be transferred to the users/ public authority which need to be scrutinised.
Funded works	In case of capital intensive works (not included in the original project design), the project authority/ public partner may take them up at their cost. The details of such works needs to be scrutinised vis-à-vis the project design and cost and assess whether the PPP model employed for the project was reasonable in view of the funded works taken up later.
Shadow fee	In case the agreement provides for shadow fees, payable by the public authority, or such provisions to insulate the concessionaire from revenue risk; its impact on the project and its viability along with the additional financial liability of the public partner needs to be scrutinised.
Contract variations	• Contract variations can lead to significant risk transfers back to the government and therefore cost increases beyond those previously approved by Cabinet. To verify that the contract specifically provided for an independent approval process for contract variations, and the same was utilised. • Whether reduction in annuity etc envisaged under contract made applicable for reduction, if any, in scope of work.
Operations and Contract management	• To verify that a full-time contract management team was in place to monitor performance against key performance indicators, approve payments and deal with contract variations. • To verify that appropriate design review procedure is incorporated into the contract which enables the team to comment on or object on design without having given their approval to them. This is so as an approvals process for design will entitle the contractor to claim that the government has co-responsibility if there is subsequently a performance failure. • Examine whether the goods and services on which various exemptions such as excise duty were granted by the Government have been utilised in the projects.
Revenue Sharing agreements	• Whether revenue from all sources have been correctly considered while arriving at the gross revenue. • Whether the calculation of gross revenue is correctly done as provided in the Concession Agreement and duly certified by the Statutory Auditors. • Whether the public authority periodically appointed the Chartered Accountants for conducting the special audit of the Gross Revenue, the findings thereof and the reconciliation of differences, of any.

	• Whether the deductions made to the gross revenue (for arriving at shareable revenue) were as per the terms of the agreement. • Whether the revenue share, royalty, taxes, duties and other payments as per the concession agreement are made correctly and on time. • In case the revenue share paid is on a provisional basis, it needs to be verified that the actual revenue share has been paid along with penalties and interest leviable. • In cases where the distributable revenues show a declining trend, the reasons for the same should be investigated and commented upon. • Whether the operation of Escrow Account i.e. deposits of revenue, receipts and withdrawal and appropriations is done as per the conditions specified in the CA. • Whether the state government has put in place any mechanism to ensure proper accountal of revenue, correct calculation of share of revenue, etc. • Whether any alternate accounting mechanism/organisation structure has been put in place to avoid booking of revenue to be shared with public authority.
Profit Sharing agreements	In addition to the concerns listed above for revenue share contracts, the following additional checks are indicated for profit share arrangements: • To verify whether the costs booked to the project for arriving at the profit, are entirely attributable to the project. • To verify that the expenditures booked are accurate (have been actually incurred) and not inflated. • To verify that the expenditures indicated are approved and in line with the contract provisions. • To verify that the manner of incurring these expenses are as per the laid down processes and are reasonable. • To verify whether the party's share of profit was calculated in accordance with the provisions of the contract and paid at such periodicity decided by the contract. • In case payments were made as per provisional estimates, whether all such provisional estimates were approved by the Competent Authority and whether the actual payable has been computed and paid within the timeframe specified in the contract.
Annuity and VGF Projects	• To verify that no payments are made until the service which has been contracted is available. For example, in a water treatment project, no payments should begin until the plant has been commissioned and water of the required quality is being received.

	• The payment should be made only to the extent that the service is available, i.e., it should be proportionate to the quality or quantity of units. • Penalties for non-performance should be large enough so that the contractor's incentive to perform or to remedy performance defects is fully aligned with the government's interests. • In case mobilisation advances are paid for annuity projects, to verify that the advances were in line with the provisions of the contract and no additional favour has been extended to the private concessionaire.
Service quality	To verify that the level of service is as provided in the contract and in case of short performance, suitable penalties are levied on the concessionaire. To verify whether provision exist for third party inspection and the same has been carried out.
Handover processes and Terminal value	To verify that safeguards are in place to ensure that the concessionaire will not default in the handover of the asset at the end of the project term or will deviate from the minimum quality / value of the asset that needs to be handed back to the public entity. Verify the expected realisable value of the underlying assets at the end of the project will not be significantly lower than that envisaged at the time of Project formulation.
Dispute settlement	To verify: • Whether the procedure prescribed has been followed in invoking the dispute settlement mechanism. • Whether the public authority has diligently followed up its case before the appropriate authority.