

## Final Report Appendix 2

### **ASSESSMENT REPORT**

## PPP pilot project assessment criteria

Prepared as part of the Twinning Project CZ04/IBI/FI/02-TL



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## 1 Introduction

This inception report has been prepared for the Ministry of Finance (MoF) in the Czech Republic. It has been drafted with the assistance of the Internal Audit Department of the Ministry of Finance in the Netherlands, the Dutch Court of Audit and Parpublica S.A., Portugal, under the auspices of the EU Twinning Light project:

On 16 November 2006 a Twinning Light (TL) Project with the title "Assistance with the assessment of PPP pilot projects" has commenced at the Ministry of Finance (MoF) of the Czech Republic. In this project the Czech Ministry of Finance will be assisted by the following member state partners:

- The Netherlands (Ministry of Finance, Court of Auditors)
- Portugal (Parpublica S.A.)

The project coordination is carried out by the Dutch Ministry of Transport.

### 1.1. Purpose of the Twinning Light Project

The purpose of the TL Project is to assist the Czech public administration (Ministry of Finance) with the assessment of PPP pilot projects and to suggest the corresponding assessment and evaluation criteria.

### 1.2. Project Approach:

**The TL-Project is divided in two components:**

- *Component 1:* Analysis of the assessment criteria for selected PPP pilot projects
- *Component 2:* Fiscal and Budgetary Impact Analysis

#### ***Ad Component 1: Analysis of the assessment criteria for selected PPP pilot projects***

Component 1 will focus on the involvement of the Czech MoF (Regulation of PPP projects team) in the assessment of PPP projects during the PPP project decision process.

On the basis of the existing regulatory framework (i.e. Concession law, other regulations and manuals), an analysis will be made to which extent the current regulatory framework enables the CZ MoF – based on its responsibility as guardian of the State Budget - to properly fill in its role in the decision-making process for PPP projects. The focus will be on **financial risk management tools** as it is the responsibility for the CZ MoF to manage the state expenditure and liabilities. Financial risk assessment in this context refers to the way the risks of the project (explicit/implicit) are identified, the way the risks are qualified (priority, chance of event occurring etc) and the monetary quantification of the identified risks.



## **Ad Component 2: Fiscal and Budgetary Impact Analysis:**

Component 2 focuses on the question of “what is needed to successfully incorporate PPP projects into the Budget in a way that ensures fiscal sustainability”. Attention will be paid to the **Eurostat** ruling and other relevant regulations, as regards to the consequences for the Budget. Additionally other budgetary aspects will be looked at: treatment of guarantees and other risks, consequences for longer-term perspectives etc. A potential link with the financial risk assessment element of Component 1 in this regard, will be taken into account.

### **The Twinning Light project approach is “bottom up”:**

An analysis of certain selected PPP pilots is incorporated in the project, to gain insight in the way the MoF is currently involved in the assessment of fiscal and budgetary sustainability of PPP pilot projects. For Component 1 a quick scan will be made of the projects mentioned below.

#### **The PPP projects concerned:**

- *Ministry of Transport: D 3 motorway*
- *Ministry of Justice: Court of Justice Ústí nad Labem*
- *Ministry of Justice: guarded prison Rapotice*

For Component 2 one specific project has been selected which will serve as an example: the Ministry of Justice: Court of Justice in Ústí nad Labem.

#### **Both Components are divided into three activities:**

- fact finding activity (fact finding mission and writing of inception report)
- provision of recommendations
- provision of training

### **1.3 Component 1, activity 1.1: fact finding mission**

Part of the first activity (for both Components) is a fact finding mission carried out by the experts to assess the current legislative and operational system in the Czech Republic.

The fact finding mission for Component 1 has taken place on and February 8<sup>th</sup> and 9<sup>th</sup>. During this fact finding an assessment was made of the current methods that are available for, and used by, the Ministry of Finance to assess PPP projects from the point of view of financial risks management. Experts from the Ministry of Finance were interviewed for the purpose of the fact finding. In addition experts from the Czech PPP Centrum and Supreme Audit Office were interviewed<sup>1</sup>.

According to the Twinning Light Contract each fact finding mission should result in an assessment report (*inception report*). The purpose of this report is to give an overview of the current system regarding the investigated subject in the Czech Republic and make recommendations for improvement.

This assessment report covers Component 1 and contains an overview of the current way PPP pilot projects in the Czech Republic are assessed by the Ministry of Finance regarding risks with financial consequences for the State (budget), and provides recommendations for improvement, based on international best practices.

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<sup>1</sup> See list of interviewees annex I



## 2 Risk management in PPP projects

**Box 1: a definition of risk management:**

The overall process of identifying, assessing and monitoring risks and implementing the necessary controls in order to keep the risk exposure to an acceptable level. Best practice suggests that it should be an embedded part of the management process rather than something, which is added at a later stage

*Source: Annex 2- PIFC Glossary of definitions*

### 2.1 Introduction:

PPP contracts can take different forms (for example: Design, Build, Finance, Operate contracts / DBFO, or Build, Operate, Transfer contracts / BOT). A PPP contract can concern a “traditional” infrastructure project, i.e. road, rail, or other sectors like healthcare, justice. However PPP projects normally share certain characteristics:

- The relatively long duration of the relationship, involving cooperation between the public partner and the private partner on different aspects of a planned project.
- The method of funding the project, in part from the private sector, sometimes by means of complex arrangements between the various players. Nonetheless, public funds - in some cases rather substantial - may be added to the private funds.
- The important role of the private economic operator, who participates at different stages in the project (design, completion, implementation, funding). The public partner concentrates primarily on defining the objectives to be attained in terms of public interest, quality of services provided and pricing policy, and it takes responsibility for monitoring compliance with these objectives.
- The distribution of risks between the public partner and the private partner, to whom the risks generally borne by the public sector are transferred. However, a PPP does not necessarily mean that the private partner assumes all the risks, or even the major share of each risk linked to the project. The precise distribution of risk is determined case by case, according to the respective ability of the parties concerned to assess, control and cope with this risk.

*(Source: Green paper on public private partnerships and community law on public contracts and concessions COM (2004) 327 final).*

### 2.2 Identifying and assessing risks

As stated above, one of the main elements that characterize PPP projects is the fact that significant risk transfer takes place from the public partner to the private partner. As a rule in a PPP project a risk should be allocated to and managed by the contractual partner that is the most able to do so.

The element of risk transfer implies that both private and public parties in PPP project need to be able to identify the possible risks of a given project, assess the chance that the risks



should occur and what the (financial) consequences would be if the risk would occur, and lastly to determine how to contain the risk and which party is best able to do so.

The process of identifying and mitigating the project risks is an important element of the preparatory process for a PPP contract. Even before the procurement stage the public partners, in cooperation with the selected consultants (if any) should have insight in the most important risks and their potential consequences. This risk assessment should be part of the comparison that should be made between a traditionally procured project and a PPP project (PSC) that is part of the value-for-money assessment of a PPP project.

### 2.3 Managing and Monitoring risks

Not only should a full assessment of risks be made during the preparation stages of a PPP project, these risks, insofar as they are implicitly or explicitly transferred to the public partner in the contract, need to be managed and monitored by the public partner for the whole duration of the PPP project. The monitoring of the risks ensures that the identified risks can be contained and unforeseen financial consequences in the form of cost overruns can be held in check.

Note that risk assessment should not address contractual risks only. In fact, some fiscal risks arising from a PPP projects are related to the possibility of cost overruns during the preparation phase, prior to contract close, and may result from insufficient effort in assessing costs, benefits and risks before the decision to call for tender.

Project spillovers and externalities need also to be considered, in order to assess cost, benefits and risks in an integrated and consistent way.

### 2.4 Tools/guidance/expertise for risk assessment in a PPP project:

- For a risk assessment a **risk matrix** will normally be used. This matrix is a tool for the project management to identify and assess risks in a structured way. To a risk matrix a more elaborate commentary on the assessed risks might be attached.<sup>2</sup>
- There should be an **organisational structure** which ensures that all relevant stakeholders in the PPP projects are involved in the assessment of risks. A Risk matrix will only be complete if all relevant stakeholders contribute to the assessment of the risks of a project from their different perspectives.

A system of **Public Internal Financial Control (PFIC) and external auditing** can contribute to the quality of the risk management of a PPP project:

**Box 2: Public Internal Financial Control (PIFC)**

Public Internal Financial Control (PIFC) represents a structured model for guiding national governments in establishing a state-of-the-art control environment in their income and spending centres (including spending ministries involved in PPP Projects). It aims to give reasonable assurance that transactions comply with the principles of sound financial management, transparency (in terms of clear lines of responsibility and in terms of harmonised methodology and standards), efficiency, effectiveness, economy and with relevant legislation and budget descriptions.

In addition, a state-of-the-art internal control environment is an effective tool in preventing corruption and fraud.

PIFC is defined as having three pillars: 1) managerial accountability, 2) functionally independent internal audit and 3) a central harmonisation unit (CHU).

*Source: welcome to the world of PFIC (draft), European Commission DG Budget 20-7-2006,*

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<sup>2</sup> For example in Portugal, Parpublica writes a full report on the risk assessment, presented to the Finance Minister in order to support PPP gateway approval/veto.



PIFC plays a key role in ensuring sound financial management in public administration.

PPP projects are complex and therefore difficult to manage and control. PFIIC can contribute to enhancing the quality level of management and control in these projects.

Basic principles of PPP are risk management (risk analysis, risk allocation, risk transfer, risk mitigation, monitoring of risks), long term view (total life cycle approach), output specification, added value, value-for-money paying mechanism based on performance and transparency. Those principles link close to PIFIC.

Public internal control itself is subject to external assessment by the Supreme Audit Institution.

- To make sure that the risks are properly assessed and allocated the public partners (as well as the private partners) in the project need to develop **knowledge of and experience with risk assessment**. Already running or finalized PPP projects should be evaluated to benefit from the “lessons learned”. In addition international best practice may be a good source to acquire practical knowledge on the do’s and don’ts of PPP projects<sup>3</sup>.

## 2.5 MoF involvement in a PPP project:

It should be noted that different public partners in a PPP project will often have different perspectives. A Line Ministry will often have a relatively short-term perspective and be mainly interested in the realization of the project. The MoF on the other hand typically has to have a long-term perspective and should assess a project from the point of view of fiscal and financial sustainability on the longer term.

The MoF, being responsible for the budget, should feel responsible for verifying that the project is financially sound and make sure that the risk of unforeseen financial liabilities that will burden future budgets is being contained.

The main MoF focus in a risk assessment should be on fiscal risks, in the meaning of risks of PPP projects with a potential financial consequence for the State finances.

Two main elements should be especially important to a MoF in that regard:

- The assessment of a project according to the **Eurostat** ruling. Only when the risks of a PPP project are correctly assessed and the main risks are transferred to the private sector, can a PPP project be recorded off balance sheet for government. The consequences of an incorrect assessment in light of the Eurostat rules will have major (negative) consequences for the State budget and debt, which is a primary responsibility of the MoF.

### Box 3. Extract from Eurostat decision 18/2004

*Eurostat recommends that the assets involved in a public-private partnership should be classified as non-government assets, and therefore recorded off balance sheet for government, if both of the following conditions are met:*

1. *the private partner bears the construction risk, and*
2. *the private partner bears at least one of either availability or demand risk.*

See Eurostat ruling 18/2004:

[http://epp.eurostat.ec.europa.eu/cache/ITY\\_PUBLIC/2-11022004-AP/EN/2-](http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/2-11022004-AP/EN/2-)

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<sup>3</sup> When making use of international best practice the country specific elements should of course be taken into account.



[11022004-AP-EN.HTML](#)

- The risks of future (major) **cost overruns** because of incomplete or incorrect assessment, managing and/or monitoring of project risks. If the risk assessment is not done properly or if the identified risks are not properly monitored and managed the financial (and political) consequences can be big. As these cost overruns will normally only occur (long) after the PPP contract is closed, these risks are not always properly taken into account. The MoF should take an interest in the risk of major cost overruns as the financial consequences most likely will have to be borne by the State budget.

### 3. Key Observations by Twinning Experts

Based on the documents that were provided to the experts and the interviews that were conducted as part of the fact finding mission, the experts have made some observations. The experts have, in their research, focused on tools, organisational structure and experience that are available for the CR MoF to help them in the identification and assessment of risks in PPP pilot projects with a potential financial impact on the State finances. For this the experts have spoken with the representatives of the department within the MoF that is responsible for PPP projects, and representatives of the Czech PPP Centrum.

In addition the experts have spoken with representatives of the Internal Audit Department of the MoF and representatives of the Supreme Audit Office to assess the role that these organisations (might) play in the improvement of the (risk) management of PPP projects.

In accordance with the scope of the TL project the experts have limited the research to the PPP pilot project structure and the MoF involvement therein. Projects that fall outside of the scope of the pilot project program have not been included in the research. However, even though these projects fall outside the scope of the TL research, some of the observations and recommendations that will be made are relevant for these projects as well.

For the purpose of structuring the MS experts have prepared a list with 5 risks with potentially major financial consequences that are common in PPP projects. This list was used in the discussions with the BC experts<sup>4</sup>.

It should be noted that, whilst reading the findings, it is important to keep in mind that the assessment of risks is partly dependent on country specific factors and will vary from country to country. The position of the MoF for example is one of these factors.

However there are some general recommendations to be made and experiences that can be shared.

#### 3.1: Findings

##### PPP pilot project structure:

*Documents used for assessment:*

- **Government resolution nr. 7 on PPP in the Czech Republic**
- **Czech Republic Government policy on Public Private Partnership**
- **Act 139/2006: Concession Act**
- **Draft governance guidance of 3 March 2005 as**

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<sup>4</sup> See annex III



produced by the PPP Centrum.

### **PPP policy**

In 2004 the Czech government by adopting regulation 7/2004 has introduced a PPP policy in the Czech Republic. This policy expressed an unambiguous support for the implementation of PPP projects<sup>5</sup>. Part of the PPP policy was the setting up of a Department within the MoF that would be responsible for all the regulation and methodology for PPP projects.

In addition the MoF would set up a body to manage PPP implementation. This **PPP Centrum** should assist the organisations involved in PPP projects in the implementation of their PPP projects. Both the Department for regulation and methodology for PPP projects (Dept 114) and the PPP Centrum were established in 2004.

In practice the MoF has delegated the drafting of manuals and certain other tasks that relate to project management, to the PPP Centrum.

It was decided that the regulations and methodologies that were to be drafted should be “tested” and implemented through a limited number of appointed PPP pilot projects. Therefore 10 projects were selected as pilot projects, some of which are central government projects, others are municipal projects. <sup>6</sup>.

Most likely the PPP pilot projects will be subject to the **Concession act**, which was drafted to improve PPP (and other Concession) projects decision-making process.

### **Concession Act**

According to the Concession act Government has to give its approval in two stages of the preparation process:

- After the feasibility study has been prepared and before entering into the procurement stage (par 22).
- Before closure of the contract (par 23).

The Concession Act concerns only projects that are covered by the Concession act (i.e. Concession contracts). Projects that are not governed by the Concession act fall outside the scope of Government approval.

In addition to this: government approval is only required for important projects on central government level (not regional/municipal level) (art. 21 Concession act). The MoF has no special position on these decisions<sup>7</sup>.

The MoF can execute budgetary supervision on PPP projects carried out by self-governing bodies (municipalities, regions etc) by ways of giving an opinion (art. 30 Concession act). The self governing body is obliged to apply for such an opinion before closing or altering a concession contract and the validity of a concession contract is conditional on the delivery of the opinion. This opinion however is not binding.

### **PPP pilot project governance**

In 2005 (3 march 2005) the PPP Centrum issued a draft document “PPP Governance Guidance”. This document describes the procedural aspects of PPP projects in the Czech

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<sup>5</sup> Policy of the Government of the Czech Republic concerning Public Private Partnership  
<http://www.pppcentrum.cz/res/data/002/000312.pdf>

<sup>6</sup> Government resolution No. 1017, on PPP pilot projects (2<sup>nd</sup> wave) and Government resolution No. 76, on PPP pilot projects (1<sup>st</sup> wave)

<sup>7</sup> In the draft governance guidance d.d. 3 March 2005 the MoF is granted a veto right in these decisions. However, the document is not formally adopted and, according to the interviewees, in practice the MoF does not have the power to exercise a veto right.



Republic. It should be noted that the current status of this document is not clear to the experts, as it is stated on the document that was provided that it is only a draft. It seems that parts of the document are being applied to the selected PPP pilot projects. Other parts of the document are seemingly not being applied or fulfilled.

In the draft document the tasks and competences of all public parties involved in the PPP pilot projects are described.

A Contracting Line ministry is responsible for the management of a PPP pilot project, in some cases the management of a pilot project has been delegated to the PPP Centrum. Often an external adviser will be hired to draft the required OBC.

For all PPP pilot Projects a Project board is established to supervise the day-to-day management of the projects. The Department for Regulation and Methodology for PPP Projects takes part in the Project Board for every PPP pilot Project.

### **The PPP Centrum:**

The PPP Centrum a.s. (joint stock company) was formed on the 1<sup>st</sup> of July 2004 under authority of the government resolution. PPP Centrum reports to the Ministry of Finance. PPP Centrum was established to speed up preparation of legal environment and methodological procedures in relation to PPP in the Czech Republic. Its public mission is to apply the best practice knowledge in governance and preparation of PPP projects. The PPP Centrum was established to act as a knowledge centre for implementation of PPP projects.

The PPP Centrum works exclusively for public partners. The MoF is one of its clients but not the only one. The PPP Centrum is established to provide advice and assistance to all public partners and *de facto* is involved in assisting other Ministries and municipalities with the management of their PPP Projects.

From the interviews the experts understand that responsibilities with regards to risk management have been divided between the PPP Centrum and the Department for Regulation and Methodology of PPP projects. According to that information the PPP Centrum should be responsible for the management of financial risks, the MoF for the management of fiscal risks although the definition (dividing line) used for both types of risks was a matter of some discussion between the experts and the interviewees.

The experts have noticed that relations between MoF and PPP Centrum are strained at the moment and that the involvement of the PPP Centrum in the PPP pilot projects is affected by this situation.

### **Internal organisational structure of MoF:**

*Documents used for the assessment:*

- **Organisational Chart MoF**
- **Document no: 2006-11-06/1: Organisational Rules of the Ministry of Finance**

### ***The State Budget Department (Department 11)***

Department 11 of the MoF is responsible for drafting the budget and drafting the relevant legislation.

### ***Department for Regulation and Methodology of PPP Projects (Department 114)***



This department is part of the State Budget Department. Department 114 is responsible for carrying out the PPP policy in general and for drafting an important part of the legislation concerning PPP (executing decrees etc., although the overall responsibility for the Concession act lies with the Ministry for Regional Development). Department 114 represents the MoF in the Project Board of the PPP pilot projects and has a responsibility to coordinate MoF input and guard MoF interests in the preparation stages of a PPP pilot project and prepares the MoF point of view in the decisions based on the Concession act. The Department has limited capacity and experience to carry out its tasks.

***The Internal Audit Department (Department 51):***

The Internal Audit Department: responsible for the Internal Audit function within the MoF. The IA department has only been established since 2002. It consists of two units: an inspection unit (for the detection of fraud) and an internal audit unit. The IA department's main focus is on EU funds. The department has limited capacity to perform audits on request and concentrates on financial audits. The operational/performance audit function is not yet developed.

***CHU (Department 17)***

The Central Harmonisation Unit is responsible for the implementation of a system of PIFC (Public Internal Finance and Control) in the Czech Republic. The Department is divided in two units: Internal Audit and FMC (Financial Management and Control). The latter *de facto* is not staffed.

The organisational rules of the MoF contain the general division of tasks and responsibilities within the MoF. There is no internal procedure (manual) within the Ministry of Finance that ensures the involvement of all relevant departments of the MoF in the analysis of the risk assessment of PPP projects.

**The Supreme Audit Office:**

The Supreme Audit Office is an independent body that is assigned the task of auditing the management of State property. The SAO is preparing its organisation for the auditing of PPP projects through training. However, practical experience is lacking. The SAO has performed an audit on a PPP project in the past but practical knowledge regarding PPP projects deriving from that audit, were limited.

The audit agenda of the SAO is determined for each budgetary year and is based on the priorities as formulated by the SAO president. It is not to be expected that a PPP pilot project will be audited in 2007 or 2008 as the audits that are part of the agenda for 2007 will effectively be carried out in 2008 (preparation is scheduled for 2007). Because of limited capacity not all PPP pilot projects can be audited and in the future only a limited number of projects will be audited. If such a PPP pilot project will be audited it will most likely be after contract closure.

**3.1.2 Tools: risk manual**

*Documents used for the assessment:*  
**- PPP project risks guidance 2005**

For the benefit of all parties involved in PPP projects, the PPP Centrum has drafted a PPP project Risks Guidance. This guidance should aid the project management in the assessment and allocation of risks by providing a structured methodology and risk matrix. As



the assessment of this manual will be part of the Twinning project CZ/2005/IB/FI/04 the experts have not assessed this manual in detail.

### **The selected PPP pilot projects**

*Documents used for assessment:*

- **Template for the proposed PPP (Public Private Partnership) Pilot Project Usti nad Labem**
- **Appraisal of the proposed PPP Pilot Project Usti nad Labem**
- **OBC first final version Courthouse Usti nad Labem**
- **fact sheet Prison Rapotice**
- **fact sheet D3 Highway**

#### Courthouse Usti nad Labem / Prison facility Rapotice

These projects are being carried out by the Ministry of Justice (MoJ).

Both projects have reached OBC stage. The first final version of OBC Courthouse Usti nad Labem has been provided in English to the experts. Decision by the Government on these projects is expected to take place in April/May.

#### D3 Motorway:

This project is managed by the Ministry of Transport. Due to some delays the project advisers have just been selected. An OBC is not expected for some time yet. The experts have not received any document containing a risk assessment in this project.

### **3.2: Analysis of the findings**

#### 3.2.1: Positive elements

The experts have identified the following positive elements in the current system in the Czech Republic:

- The existence of governance guidance as such: draft Governance Guidance provides a structure for the management of PPP. The document contributes to the involvement of all necessary parties in the project. The Draft guidance takes into account the specific interests and responsibilities of the MoF and provides an opportunity for the MoF to carry out its tasks by stipulating that the MoF should be represented in the Project Board of a PPP project. However the document is only a draft and the status is unclear. As the content of the governance guidance is part of the Twinning project CZ/2005/IB/FI/04, no comments will be made on the content of the draft guidance.
- The existence of a Department for Regulation and Methodology of PPP Projects within the MoF.  
One of the tasks of the Department is to represent the MoF in the Project Board of the PPP pilot projects. In the opinion of the experts it is imperative that the Ministry of Finance is closely involved in the preparation and monitoring of PPP projects. Different stakeholders in a PPP project will have different goals. The MoF is normally the government institution that is best able to guard and protect the State finances. The involvement of the MoF should therefore primarily focus on the specific – long term – financial interests of the State finances. It should be noted that the extent of the MoF can differ according to different countries. The experts do not want to



express a preference for a certain division of tasks between a MoF and other Ministries, external consultants or a PPP Centrum.

However, a MoF in the opinion of the experts should not, taking into account its own responsibility for the State Finances, “outsource” all involvement in the (risks) management of PPP projects. It should be involved and capable to guard the interests of the State budget and finances in PPP projects.

- Awareness of the necessity of MoF involvement in risk assessment: The members of the Department for Regulation and Methodology are aware of the importance of MoF involvement in the management and monitoring of PPP projects from the State Finances point of view. They realize that it is very necessary for them to – although maybe not to carry out a risk assessment – at least be able to verify that the risk assessment that has been carried out is valid and complete.
- The existence of a Risk Guidance manual: A risk manual is a helpful tool for all partners in a PPP project to identify, quantify and allocate risks in a structured way. As the assessment of the Czech manual will be part of the Twinning project CZ/2005/IB/FI/04 the experts will not comment on the content of the Risk Manual.
- An Internal Audit function is being developed within the Czech Republic and within the MoF. As stated in the first chapter of this report, an internal audit function can contribute to the quality of management and monitoring of PPP projects. However until now the Internal Audit office has not been considerably involved in the PPP projects.
- PPP projects have the attention of the Supreme Audit Office. In addition to an internal audit function also the Supreme Audit Office will have to play a role in evaluating and improving the use of financial state resources in PPP projects. The Supreme Audit Office is very aware of the necessity of auditing PPP projects. It is also aware of the limited role of the internal and external audit at present.

### 3.2.2. Challenges:

The experts have also identified several challenges that the Czech Republic, and especially the MoF, faces with regards to the (risk) management and monitoring of PPP projects.

- The experts conclude from their research and interviews that, although the PPP pilot structure allows for a thorough assessment and monitoring of PPP pilot projects by the MoF in the preparation stages, the input of the MoF in the actual projects seems limited and *ad hoc*. Reasons for this can be found in the organisational embedment and insufficient knowledge and expertise in risk assessment in PPP pilot projects.
  - The Department for Regulation and Methodology of PPP Projects has not formulated clearly a desired role and level of MoF involvement in PPP pilot projects either during preparation stage or during the monitoring stage.
  - The work of the Department is influenced by the fact that there is only limited staff available. The Department is hesitant to accept more responsibility without increased staffing. Internal backing of the Department within the MoF seems limited.
  - An organisational structure within the MoF that ensures structured involvement of all relevant MoF departments in the MoF input in PPP pilot projects does not exist. The Department for Regulation and Methodology of PPP Projects has the task to coordinate the MoF input in the PPP pilot



projects. Often it will send out requests for assistance to other departments within the MoF. As the time to prepare the input is often limited, the Departments do not always provide the requested information. There is no agreement within the MoF that ensures commitment of the other Departments to provide their expertise for the preparation of the MoF input.

- A clear agreement on the division of tasks between the Department for Regulation and Methodology of PPP Projects and the PPP Centrum in this regard, does not seem to be in place.
- Practical experience with, and knowledge of risk assessment methods in PPP projects, is very limited within the Department for Regulation and Methodology of PPP Projects. Capacity again is an issue here as well. The Department is not sufficiently able to verify that the results of a risk assessment are valid.
- The experts find that the internal and external audit function is not yet fully developed as regards the auditing of PPP projects. It is not to be expected that internal or external audits will be performed on the PPP pilot projects in the near future.

#### **4. Recommendations:**

- The experts recommend that the Department for Regulation and Methodology (MoF) clearly determines the extent of its involvement in the PPP decision process, especially with regards to assessment, management and monitoring of PPP project risks not only in the preparation phase but also in the monitoring phase. Attention should also be paid to the monitoring of risks *after* the contract is closed and the level of involvement of the MoF therein. In this regard also the specific division of competences within the departments of MoF especially regarding the management of risks with a financial impact should be looked into in PPP pilot projects both during preparation stage and during the monitoring stage.
- It is important that the MoF clearly formulates the extent of the Department competences and the PPP Centrum competences. However, the MoF should not “outsource” all responsibility to the PPP Centrum. At a minimum the MoF should keep the responsibility for containing risks with a major financial impact for the budget and have the ability to verify the validity of risk assessment and to monitor what is carried out by the project management (ask the right questions). The MoF should keep control of the risk management because it is the MoF that will be held accountable. In addition a full transfer of responsibilities could lead to a potential conflict of interest as the PPP Centrum is not meant to work exclusively for the MoF and is also involved in the provision of advice and management skills to Line Ministries.
- The Control Process presented in the draft PPP Project Governance Guidance, (section 7) including six assessment gateways, should be developed, in order to specify clearly the role of each organisation (MoF, line ministries, PPP Centrum) in each phase of the project. In particular, the role of the MoF needs to be carefully presented, distinguishing the political competences (Finance Minister approval, Finance Minister veto power) from the technical competences (cost assessment, risk assessment, budgeting) that provide support to political decisions.

The PPP Control Process (typically a gateway process) that a government adopts shall be compatible with the institutions of the country and their capabilities – different institutions, different organisational design of government and public administration, will require different control processes. But the chosen process needs to state clearly,



for each gateway, which institutions will control for efficiency, affordability and sustainability.

- To be able to define the MoF involvement as suggested above and to carry out its task and guard the MoF interests in the PPP project management, the Department of Regulation and Methodology of PPP Projects will have to take steps to increase the level of knowledge and experience of its staff regarding the assessment and monitoring of risks.

Training current and future staff may involve formal training, as well as secondments to PPP Units or similar departments in the MoF of other countries. The European PPP Expertise Centre (EPEC), currently being created by EIB with strong European Commission sponsorship, will provide a forum for debate that will help to increase the capacity of the Department for Regulation and Methodology of PPP Projects.

- It is recommended that an organisational structure should be in place to ensure timely and continuous involvement of all the relevant MoF departments in the preparation of the MoF point of view.
- In future, the possibility to involve the audit function to improve the quality of the process should be looked into.

## **5. Agreed upon actions**

The Dutch and Portuguese experts have agreed during the fact finding meetings to execute the following activities and provide the following information to the Czech authorities to help carrying out (some of) the recommendations. Further assistance will be provided to the Czech authorities during the course of them carrying out the recommendations, depending on the need of the Czech authorities and availability of the MS experts.

- The experts will assist the Department for Regulation and Methodology of PPP Projects in increasing the level of knowledge, skills and professional expertise regarding risk assessment. To start with, the experts will assess an OBC (English version) that is currently being discussed in the Project Board of the given project. Most likely the OBC for the MoJ prison project will be the most suitable as discussions on the Courthouse OBC has already progressed to the government decision level. The experts will provide the Department for Regulation and Methodology of PPP Projects with a list of questions that can be raised regarding the risk assessment in the OBC. The Department can consequently use these questions to start a discussion with all stakeholders involved in the PPP project on the assessment of risks and potential financial consequences for the State and acquaint itself with the risk assessment process. The experts will be available to discuss any problems and findings the Department will encounter during the discussions with the staff of the Department.
- Information will be provided on the organisation structure and practical workings of the organisation structure in Portugal and NL to the extent requested by the MoF. This information can help the Department for Regulation and Methodology of PPP Projects to determine the steps it will want to take to improve the quality of MoF input in PPP risk management. The experts will be available to discuss and answer any question from the Department in this regard. The information to be shared concerns the following subjects (not limited)
  - Information on organisation structure and division of responsibilities in Portugal and Netherlands regarding PPP project management.



- Information on risk assessment for PPP projects
  - Information on performance auditing of PPP projects
- Any other available information that is deemed relevant for the Czech authorities will of course be provided.

## **Annex I: List of interviewees<sup>8</sup>**

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<sup>8</sup> An interview with MoJ could not be arranged due to unavailability MoJ. An interview with MoT was



### **Ministry of Finance**

1) Department 114 - PPP Regulation and Methodology

Ms. Kateřina Helikarová	Head of Department
Ms. Dagmar Hrnčířová	
Ms. Vladimíra Trojanová	

2) Department 561 – Internal Audit

Ms. Jolanda Sládková	Head of Department
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### **PPP Centre**

Mr. Filip Drapák	Chairman of the board
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### **Supreme Control Office (Court of Audit)**

Mr. Josef Polák	
Mr. Vladimír Sloup	

### **Other**

Mr. Anders Nilsson	RTA - Twinning project Public Internal Financial Control
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## **Annex II: List of research documentation**

1. Czech Republic Government policy on Public Private Partnership
2. Government resolution nr. 7 on PPP in the Czech Republic
3. Act 139/2006: Concession Act + implementing regulation
4. Draft governance guidance of 3 March 2005 as produced by the PPP Centrum
5. Document no: 2006-11-06/1: Organisational Rules of the Ministry of Finance
6. Organisational Chart MoF
7. PPP project risks guidance 2005
8. Fact sheet MoT PPP project D3 Highway
9. Fact sheet MoJ PPP project Guarded Prison Rapotice
10. Outline for the proposed PPP (Public Private Partnership) Pilot Project Usti nad Labem
11. Appraisal of the proposed PPP Pilot Project Usti nad Labem
12. OBC first final version Courthouse Usti nad Labem
13. Press Release (2005) of Supreme Audit Office on Audit PPP project Highway 47

## **Annex III: List of PPP risks**



## Five major financial risks to PPP projects

**Risk 1:** Lack of **continuous qualitative project management** in all stages of the project. If continuous quality of project management is not ensured the government will not be able to properly enforce the contract provisions.

**Risk 2:** Lack of comprehensive, complete and explicit **definition and allocation of risks** between public and private parties. This will certainly result in the government ending up with the unpaid bills.

**Risk 3:** Lack of proper and very detailed **awareness of/vision on the input and required output** of the project (what should come out of it), and its foreseen **changes** in the future. In the case the provisions in the contract containing the defined output and how to change the output are not completely clear the government runs the risk of having to pay disproportionately for every change in the contractually specified output.

**Risk 4:** So called **interface risks**: lack of proper definition of the project in relation to its environment. Interface risks, if not properly identified and managed, pose a huge potential risk for cost overruns for the government.

**Risk 5:** Lack of reliable, accurate up front **calculation of the unitary charge**, for example because of omission or incomplete calculation of cost categories. As a result the government will end up paying significantly higher fees than originally – i.e. at the stage of the OBC – was foreseen.