

A Guideline for Monitoring

This guideline shows some points, etc. to be noted in considering how a Private Finance Initiative (PFI) project implemented by the national government should be monitored as one of the practical indicator for the national government in the implementation of PFI projects. The national government of Japan should implement PFI projects in accordance with the Act on Promotion of Private Finance Initiative (Act No. 117 of 1999; hereinafter referred to as the “Act”) and the Basic Policy on the Implementation of Projects on the Private Finance Initiative (Cabinet Decision of October 23, 2018; hereinafter referred to as the “Basic Policy”), and in line with these guidelines. The guidelines can also serve as a reference in PFI projects implemented by persons other than the national government.

The guidelines do not prevent each ministry and agency from devising methods according to the situation in accordance with the Act and the Basic Policy for the smooth implementation of PFI projects, and implementing of the PFI projects by methods other than those indicated in the guidelines.

Based on the implementation status of the PFI projects and the progress, etc. of investigations and studies pertaining thereto in the future, a part or all of the guidelines will be changed as necessary or new guidelines will be provided.

Unless otherwise provided herein, the terms used herein shall have the meanings as provided in the Act and the Basic Policy.

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I. Basic Concept of Monitoring

1. Introduction

The purpose of the PFI project is to outsource the provision etc., of the public facility, etc. and the provision of public services at the facility to a selected private business under a public-private partnership based on the appropriate division of roles between the public and private sectors and to provide affordable and good service to the citizens. For this reason, the administrator, etc. outsourcing the project should keep in mind the dialogue with private businesses and shall indicate the level of public services to be provided. The administrator, etc. shall select a private business after public invitation (hereinafter referred to as the “appointed business”), and shall conclude a PFI project contract (hereinafter referred to as the “PFI project contract”) for a specific project (hereinafter referred to as the “selected project”) proposed by the appointed business and provide the details of the project to be implemented as a part of the contract obligations. Monitoring is an important means of confirming the proper implementation of public services provided by the appointed business so that proper and reliable services are provided in accordance with the contract. In monitoring, the administrator, etc. of the public facility, etc. (hereinafter referred to as “the administrator, etc.”) in the selected project shall monitor (measures and evaluates) the level of public services provided by the appointed business under his/her responsibility. Monitoring also motivates the appointed business to improve their work by appropriately evaluating and disclosing the monitoring results.

Article 4.4 (3) of the Basic Policy stipulates the following requirements to ensure the provision of appropriate public services.

- [1] The administrator, etc. shall be entitled to monitor the level of public services the appointed business provides.
- [2] The administrator, etc. shall be entitled to regularly request the following from the appointed business:
 - i) Reporting on project implementation status
 - ii) Reporting on the financial situation after being audited by a certified public accountant, etc.
 - iii) Reporting on the situation in the event of a significant adverse impact on the implementation of the selected project.
- [3] Taking necessary and rational measures to ensure a proper and reliable provision of public services and means to provide relief to the administrator, etc. is provided.
- [4] The involvement of the administrator, etc. beyond the scope of the PFI project contract, etc. shall be limited to the minimum necessity, such as inspections for ensuring safety and environment conservation.

The Basic Policy requests that the administrator, etc. should agree on the above in the PFI project contract while keeping in mind to his/her involvement in the private business to a minimum.

* Article 4.4 (3) of the Basic Policy

To ensure the provision of appropriate public services while keeping in mind to his/her involvement in private businesses to a minimum, the administrator, etc. of the public facility, etc. shall take into consideration the following matters and agree on them in the project contract.

- (a) The administrator, etc. of the public facility, etc. shall be entitled to monitor the level of public services provided by the appointed business.
- (b) The administrator, etc. of the public facility, etc. shall be entitled to request the appointed business on a regular basis to submit a report on the project implementation status related to the fulfillment of the obligations set forth in the project contract.
- (c) The administrator, etc. of the public facility, etc. shall be entitled to request the appointed business to submit a report audited by a certified public accountant, etc. on the financial situation not exceeding a range that may affect the implementation of the selected project on a regular basis.
- (d) In the event of any situation that may have a serious adverse impact on the implementation of the selected project, the administrator, etc. of the public facility, etc. shall be entitled to request the appointed business to submit a report on the status and a report on a survey conducted by a third-party expert.

- (e) Necessary and rational measures to ensure a proper and reliable provision of public services and means to provide relief to the administrator, etc. of the public facility, etc. shall be provided.
- (f) The involvement of the administrator, etc. of the public facility, etc. in the selected project beyond the scope of the project contract set forth in (a) to (e) above should be limited to a reasonable range required to ensure a proper and reliable implementation of the selected project, such as inspection and monitoring for ensuring safety and environment conservation.

There is a tendency to regard monitoring as a mere formal practice after concluding a PFI project contract, etc., but this is not right.

With regard to the monitoring, the details of [1] and [2] should be provided in the PFI project contract in consideration of the measures specified in [3] above while keeping [4] in mind to ensure the continuity of the level of public services and the project. The monitoring is closely related to how the level of public services should be supervised and how service compensation should be paid in the first place. It should be recognized as an important issue to be clarified as a prerequisite for the call (bid announcement).

The financial situation of the appointed business and how to respond to a sudden event are important things to consider to ensure project continuity, but this guideline first focuses on monitoring (measurement/evaluation) of the level of public services provided by the appointed business.

Monitoring is needed at each stage, such as design, construction, maintenance, and operation of the facility, but this guideline mainly covers concept, etc. on monitoring only from the stage at which the facility is put into service or the service provision is started after the facility is completed to the end of the project.

There are two methods of paying the PFI project cost: (a) The administrator, etc. pays all or part of the project cost to the appointed business as a consideration for the public services provided by the appointed business (hereinafter referred to as the “service consideration”) and (b) the selected project collects all the PFI project cost in the form of a fee income from the beneficiaries of the public services. It should be noted that the business discipline and the measures, etc. to be taken by the administrator, etc. varies depending on which payment method is used.

* The term “service consideration” includes the costs for constructing, maintaining and operating the facility, etc. unless otherwise specified.

2. Building a Framework to Ensure a Proper and Reliable Implementation of Public Services

(1) Importance of building a framework to ensure a proper and reliable implementation of public services

As mentioned at the beginning of 1, the PFI project aims to provide affordable and good service to the citizens, so when the administrator, etc. plans a project, it is important to establish a system not only to increase Value for Money (VFM) but also to ensure the level of public services and business continuity through the maintenance and operation stages.

Finally, a draft PFI project contract, etc., which is shown at the time of the call of private businesses (bid announcement) includes the following items:

- [1] Details of the obligations of both parties and how to fulfill them
 - Content and quality of public services provided by the appointed business
 - Method for measuring and evaluating the level of the public services
 - Fee and calculation method, etc.
- [2] When the parties violate the rules, such as PFI project contract
 - Appropriate and rational measures necessary for rectifying the selected project
 - Default recovery measures and relief measures, etc., for the non-violating party

Specifically, the following measures are included as provisions when public services are not provided properly (default is confirmed, etc.): Voluntary improvement by the appointed business, notification from the administrator, etc. to make improvements, improvements to be made by the appointed business, reduction of service consideration, correction notice, contract cancellation, etc. It is important to carefully set these provisions etc.

The administrator, etc. should be fully aware of the interrelationship of these provisions, and in particular, measures should be taken in response to default confirmation not to pose an excessive risk to the appointed business, so criteria for applying these measures should be determined carefully.

In the PFI project, the private business collects the project cost exclusively by receiving the service consideration and often establishes a new corporation to conduct the project when selected as a contractor. Accordingly, the continuation of the project and the survival of the appointed business depend on the PFI project contract.

If the PFI project contract includes [1] provisions that impose a considerable burden on the appointed business, such as reduction of service consideration, rectification, and relief, and [2] provisions that particularly emphasize a procedure for providing relief to the administrator in the event of default by the appointed business, the administrator, etc. may exercise the right to cancel the contract at the time of default by the appointed business. In such a case, the increased risk provides the lending financial institution an excuse to add an extra interest rate as a risk premium, reducing VFM or destabilizing the PFI project contract itself.

In other words, the inclusion of provisions, such as [1] and [2], poses a big risk to both the investor of the project and the lending financial institution, and the appointed business etc. may also determine the contract to be irrational.

(2) Details of the framework to ensure a proper and reliable implementation of public services

The framework to be built will naturally vary from project to project according to the content of the projects and the risk allocation involved. To ensure and maintain the level of public services of the selected project, this framework assumes that the appointed business will improve on defaults at its own responsibility if confirmed.

For example, the details of the following matters should be determined.

[1] Construction of a basic system to ensure and maintain the level of public services

Build a system that enables the appointed business to independently ensure and maintain service levels through economic motivation.

i) Service content and quality (required level)

Create a service level requested by the administrator, etc. and the judgment criteria for confirming that the required level is met.

ii) Service level measurement and evaluation

Summarize the overall framework for monitoring, the division of roles between the public and private sectors and an organizational system for monitoring and the concept of measurement, recording, reporting, etc. for monitoring.

iii) Payment of service consideration

Summarize a method for calculating service consideration.

This includes the amount of payment when the required level is not met, and provision of a certain improvement period to ensure appropriate public services.

[2] Countermeasures taken in the event of continuous default, etc.

Correction notices and contract cancellations may be taken as measures to deal with repeated

defaults that are not rectified within a certain improvement period, or defaults that have a significant impact on the provision of public services.

Figure 1-1 illustrates the above flow.

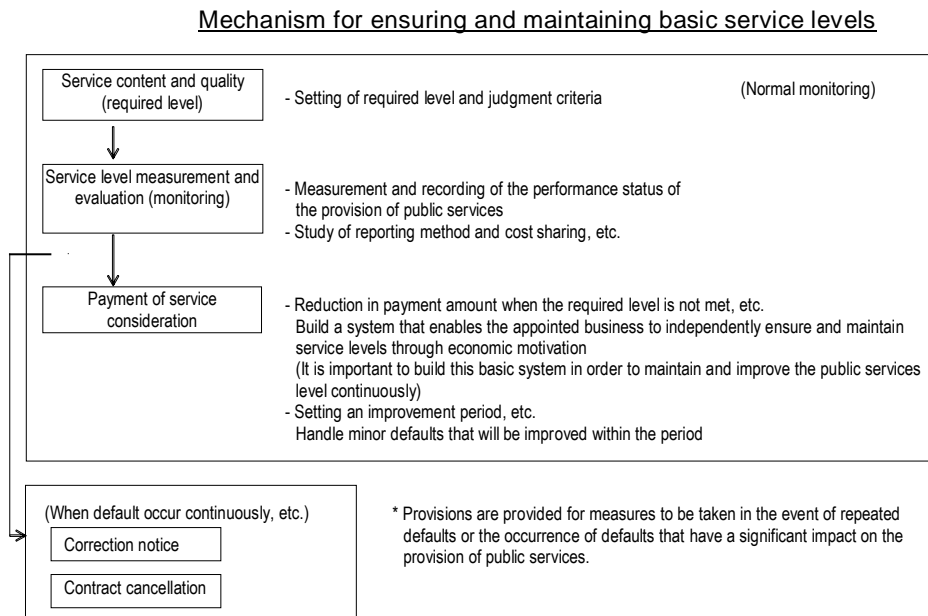


Figure 1-1

In the PFI project, payment to the appointed business is generally made as a consideration for appropriate services after the facility is put into service or the service is started, etc. For this reason, an effective way to financially motivate the appointed business is to reduce the service consideration according to the performance status of the public services provided.

* Alternatively, the service consideration may be determined according to the service level to give an economic motivation.

For example, the service consideration may be paid according to the usage amount of public services required by the administrator, etc. In this case, the service consideration is calculated by multiplying the fixed unit price by the usage amount. Alternatively, if the quality or quantity of public services provided exceeds a certain level, the corresponding service consideration may be paid. In any case, sufficient attention should be paid to the following points:

- To secure a budget for payment of consideration according to the service level, the administrator, etc. must be able to reasonably explain the necessity of such payment and the calculation method of the service level.
- In particular, it should be noted that the payment of increased service consideration for the quality and quantity exceeding a certain level cannot be justifiably explained from the viewpoint of a proper execution of the budget only because the quality and quantity exceed the required level.

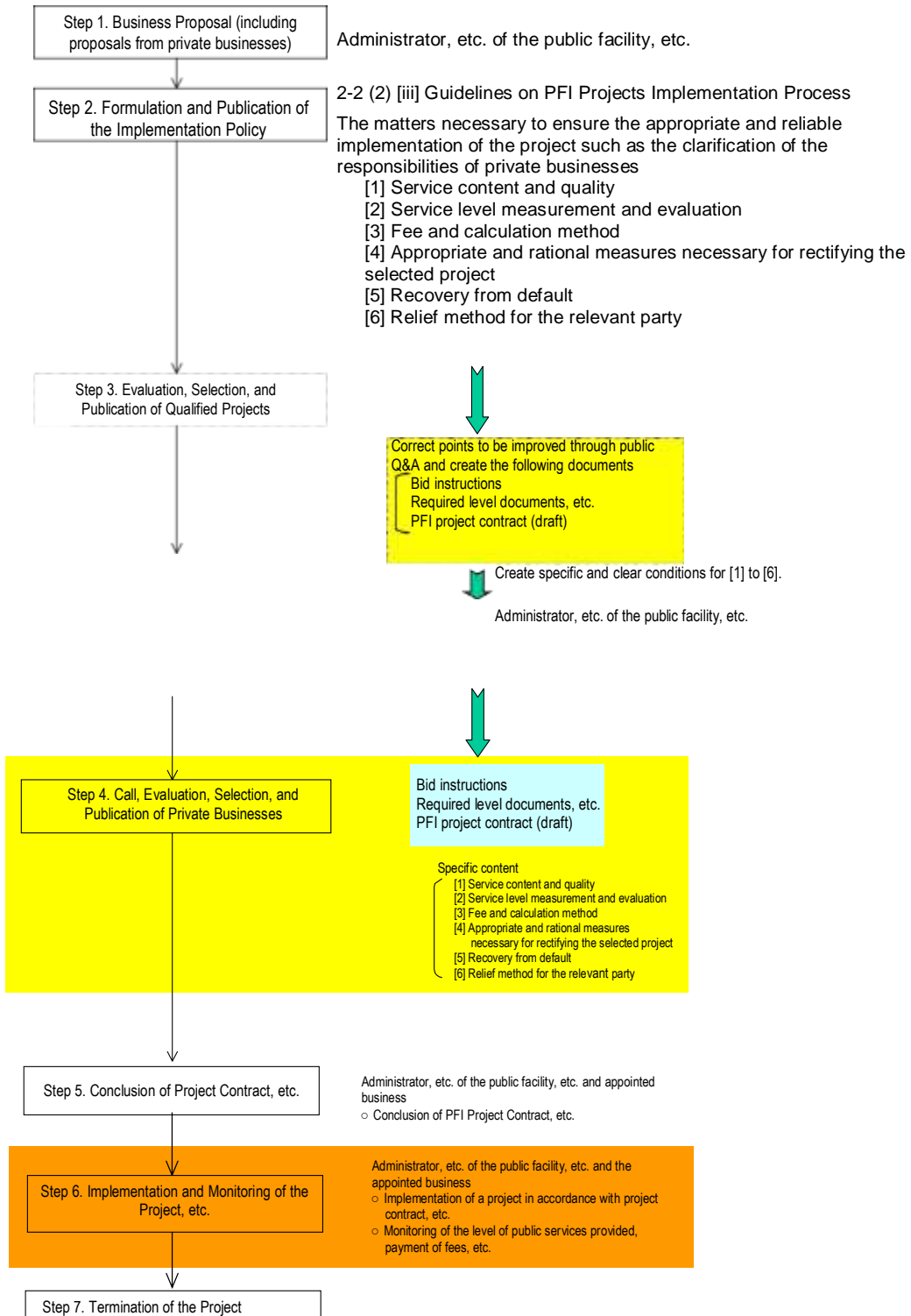
(3) Process from the building of a monitoring system to the implementation of monitoring

Figure 1-2 below chronologically shows the items that the administrator, etc. should be aware of regarding monitoring.

The specific act of monitoring is to monitor the level of public services provided at the project implementation stage. These specific monitoring actions should be clarified in the required level documents, etc. and the draft PFI project contract.

Regarding this point, the “Contract principle” is emphasized in the Basic Policy as follows: “The division of roles and responsibilities of the parties should be clarified in the form of contract.” Article 4-1 (7) “Guidelines for PFI project implementation process” also stipulates that at the time of the call of a private business, “methods for payment to private businesses and penalties for them” should be specified as specific as possible in advance so that the intentions of the administrator, etc. regarding the call can be accurately communicated.

Figure 1-2 Process from the building of a monitoring system to the implementation of monitoring



The required level documents, etc. and a draft PFI project contract are prepared by the administrator, etc. in line with the concept of the framework of the entire project. At the time of preparation, the following items should be provided specifically:

- [1] Criteria for ensuring that the content and quality of public services provided by the appointed business meet the required standards.
- [2] Establishment of measurement targets subjected to judgment and measurement implementation system
- [3] Service consideration based on the judgment results
- [4] Measures to be taken when the required level is not met (default)

What is clarified here is the conditions under which private businesses evaluate the content and risk of the project, and determine their service consideration. These conditions are also important judgment criteria for the financial institution that provides necessary loans for this project.

Accordingly, these contents should be presented at the earliest possible stage in the form of a draft required level document, etc. or draft monitoring standard, for example, when formulating an implementation policy and should be then presented in the form of a final document that widely reflects opinions obtained through questions and answers at the stage of the call (bid announcement) of private businesses.

The draft monitoring standard is prepared on the assumption that it is positioned as part of the Draft PFI project contract. When creating a draft monitoring standard, “Monitoring Standards (Template)” may be used.

II. How to Implement Monitoring

1. Implementation of Monitoring

Monitoring involves the following activities:

- [1] Collecting data and samples to understand and verify the performance status of public services provided by the appointed business.
- [2] Promptly implementing corrective measures if it is found that the level of public services provided does not meet the required level set forth in the PFI project contract.
- [3] Measuring the collected data, samples, implementation status of corrective measures, etc. to see if they meet the required level of public services, and evaluating performance based on the results, etc.

The ultimate responsibility for monitoring lies with the administrator, etc. and the performance evaluation, etc. set forth in [3] must be performed by the administrator, etc. For [1] and [2], it may be more rational for the appointed business to take actions or measures. Monitoring implementers should be determined for each project.

If the implementation of monitoring reveals that appropriate public services are not provided, corrective measures should be taken promptly.

To achieve that, a system for collecting information together with the appointed business should be established to ensure that public services are monitored adequately, including those that are difficult to measure, and that information about the performance status of public services for selected projects is communicated.

Many PFI projects have been technically devised from the design stage to achieve future maintenance at low cost, with a view to reduction in life-cycle costs. For the facility (or structure, etc.), it should be first monitored whether maintenance work is being performed properly in accordance with the concluded contract. Unfortunately, such normal maintenance activities may preclude the grasping of fatigue and deterioration of the facility itself, which may result in a sudden big problem due to fatigue and deterioration that has progressed over a long period of time.

If the appointed business is supposed to perform maintenance, including large-scale repairs, the administrator, etc. should request it to submit a medium- to long-term repair plan based on the contract and confirm a proper implementation of such repair through monitoring.

For such medium- to long-term repairs, the administrator, etc. may specify the required level.

2. Specific Contents of Monitoring

(1) PFI projects normally assume performance-based ordering, so the appointed business will create a business plan to reach the required business level and provide public services according to the plan.

The administrator, etc. should determine specific judgment criteria in advance, clarify monitoring targets, implementers, methods, etc., and confirm whether public services are provided in accordance with those above.

Some public services can be measured with the measuring equipment and have results that can be indicated with measurement indicator, while others cannot. The administrator, etc. should show the criteria for determining that public services meet the required level even for the un-measurable public services. (For un-measurable public services, for example, whether or not they meet the required level may be determined from a business process of the appointed business, for example, conducting staff training).

The judgment criteria should not be limited to one. Any criterion that is suitable for the project is acceptable, for example, “the number of justifiable complaints is X or less.” The judgment criteria should be devised into measurable ones.

* The following paragraphs describe “complaints,” “improvement requests,” “service requests” from the service beneficiaries and “satisfaction surveys.” The collected information may include requests that go beyond the scope of the selected project. It is desirable for the administrator, etc. and the appointed business to use this information to improve the project.

However, it should be noted that when it comes to reduction of the service consideration based on such information from the service beneficiaries, information that is directly linked to the default of the appointed business must be extracted and the parties must discuss whether the extracted information really represents the default of the appointed business.

In any case, the monitoring method etc. depends on how the judgment criteria are determined, so it is crucial to select a monitoring method that is suitable for the project.
(Refer to “IV. Measurement Indicators Required for Monitoring”)

(2) - In general, the monitoring involves the following activities:

[1] Confirming performance details with reports, etc.

- i) Check whether reports, such as business reports, etc. agreed between the administrator, etc. and the appointed business, are submitted by the deadline set forth in the contract.
- ii) Check whether the specific contents of the report meet reporting requirements.
- iii) Check whether complaints, etc. from service beneficiaries, etc. have been dealt with appropriately.

[2] Confirming facts

Check whether what is written in the report is a fact in the first place.

For example, to visit a site requiring rectification to check if the rectification was performed as stated in the report.

- The methods for confirming facts include:

[1] Measurement with measuring equipment

Measure the amount of processing, etc. with measuring equipment.

[2] Sample extraction

For items for which safety or hygiene standards, etc. are established, randomly select the targets and check whether the standards are met.

[3] Unannounced confirmation on site

Confirm without any advance notice whether the contents of public services provided in the specifications, etc. submitted by the appointed business are implemented properly.

[4] Complaints, etc. from service beneficiaries, etc.

Obtain information on complaints, etc. from service beneficiaries, etc., especially for stand-alone-type projects (right to operate the public facility, etc. procedures, etc.), which receive no payment of service consideration from the administrator, etc.

- Other monitoring methods include customer satisfaction surveys, which show how satisfied the beneficiaries are with the customer services they received.

- The frequency of monitoring should be determined based on the content of services, such as daily monitoring and regular monitoring for a certain period of time, as well as irregular monitoring and

unannounced monitoring, etc.

- In conducting monitoring, the administrator, etc. need not do everything by itself and should establish a monitoring system according to the content of the project and conduct it in cooperation with the appointed business, the beneficiaries (users, etc.) of public services, specialized agencies, etc.

-The administrator, etc. may obtain opinions on the monitoring from a fair and neutral standpoint of third parties, such as academic experts, as needed.

(3) When defining a concrete monitoring method, the monitoring implementers, the severity of each service, the cost of monitoring, etc. should be taken into consideration. Depending on the monitoring target, multiple methods may be combined to select the one that best suits the monitoring target. It should be noted in particular that spending more money and time than it is necessary in monitoring is not desired in terms of the efficiency of the entire project.

3. Information Collection System for Service Performance Status

(1) Even if each monitoring activity works well, the services may not be provided properly unless the information collected from the monitoring is centrally managed and this state may not be rectified or improved promptly.

So, it is crucial for the administrator, etc. and the appointed business to have a unified view of monitoring so that they can share information.

Figure 2-1 shows monitoring implementors, monitoring targets and an information flow.

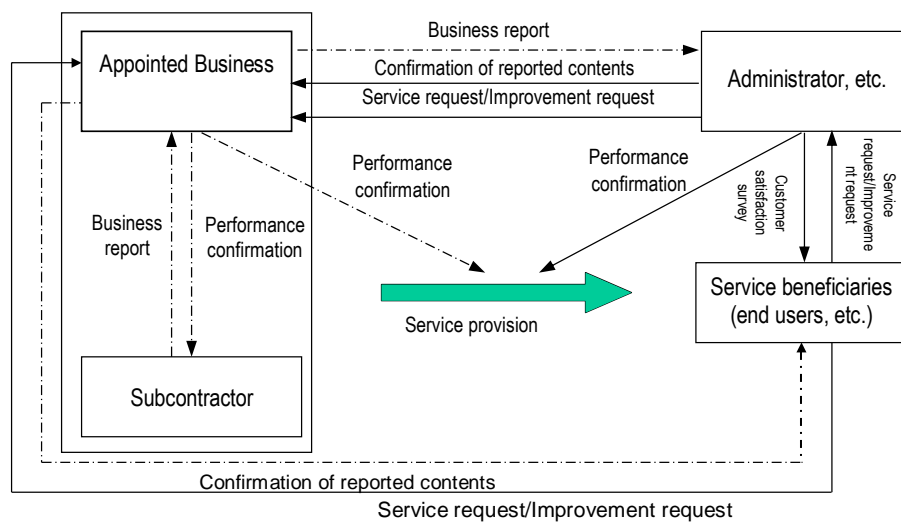


Figure 2-1 Monitoring implementors and monitoring target

The following paragraphs describe the monitoring implementors and the details of the monitoring:

<Administrator, etc.>

- Confirm a business report submitted by the appointed business and notify the same of the confirmation results.

Confirm the business report together with the following results and complaint information from the service beneficiaries:

- Check the performance status of the services regularly or as needed.
- Physically measurable service: Measured by the administrator, etc. or a specialized agency, etc.
- Physically non-measurable service: On-site confirmation of service provision state, etc.
- Satisfaction survey of service beneficiaries, etc.

<Appointed business>

The following activities are conducted for doing self-audit (self-monitoring):

- Check the performance status of the service provision system and quality control system including those of subcontracting companies.
- Check the performance status of the services regularly or as needed.
- Physically measurable services: Equipment is used to record and store the measurement results.
- Physically non-measurable service: On-site confirmation of service provision state, etc.
- Create a business report and submit it to the administrator, etc. on a regular basis.
- Satisfaction survey of service beneficiaries, etc.

<Service beneficiaries (end users, etc.)>

Make a complaint or an improvement request to the administrator, etc. or the appointed business.

<Third parties, such as academic experts>

For facilities with high expertise, etc. (hospitals, water and sewage facilities, waste treatment facilities, etc.), those who have specialized insights, etc., check the implementation status of facility maintenance and operation from a fair and neutral standpoint.

(2) The business diary and business report are important tools for sharing information. The submission of the business diary and business report from the appointed business to the administrator, etc. for the purpose of monitoring is normally included in the PFI project contract. The following paragraphs show an exemplified content of the PFI project contract.

- The appointed business shall create a business diary that describes the implementation status of facility maintenance and operation, keep it for a certain period of time, and make it available when requested by the administrator, etc.
- The appointed business shall create a business report on the implementation status of maintenance and operation based on the business diary and submit it to the administrator, etc. at a fixed frequency until the end of the PFI project contract and receive performance confirmation.
- The appointed business shall describe how it handled defects or unachieved items in the business diary and business report.
- The administrator, etc. shall confirm the business report submitted by the appointed business and notify the same of the results within a predetermined period of time.

(3) Information should be finally collected to the administrator, etc., who has the ultimate responsibility for monitoring. The appointed business should unify the reception desk and centrally conduct the management of information so as not to inconvenience the service beneficiaries.

* If the service content is diverse or a lot of responses to service beneficiaries are expected, the appointed business may have a centralized department (help desk) that specializes in handling them. If the administrator, etc. determines it necessary to establish such a specialized department, it should be included in the required level documents, etc.

(4) To conduct monitoring comprehensively and appropriately, a system should be built that can reflect information from wide-ranging monitoring implementers. Core monitoring methods, implementation frequency, complementary monitoring methods, etc., should be also considered, taking into account the content of the services and the cost incurred in monitoring, etc.

In monitoring a road, for example, it is important to confirm whether the environmental safety standards are complied with in terms of noise, vibration, exhaust gas, etc. originating from the road. To achieve that, the appointed business installs an environment measurement device, performs continuous measurement, records the measurement results and stores them. The administrator, etc. conducts monitoring basically by checking the report on measurement results, but if necessary, visits the site and performs measurements deemed necessary at his/her expense.

For structures, such as tunnels and bridges, their fatigue and deterioration may suddenly cause a big problem. To prevent such a situation from arising, the administrator, etc. needs to monitor whether the appointed business conducts regular inspections and does proper repairing.

The appointed businesses performing quality control normally conduct audits, etc. on their own business contents. The quality control performed by the appointed business can be regarded as monitoring. In this case, the administrator, etc. may establish a monitoring framework that complements it.

Figure 2-2 shows a self-auditing flow, etc. of the appointed business performing quality control and the key points for monitoring conducted by the administrator, etc. to complement it.

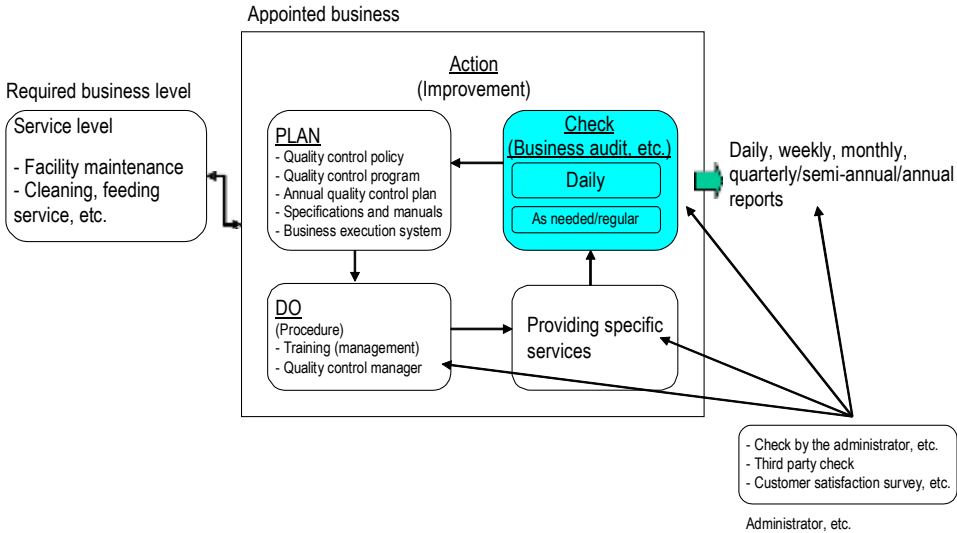


Figure 2-2 Example of basic monitoring flow for appointed business performing quality control

4. Finalizing Monitoring Method, etc.

The administrator, etc. organizes the methods and systems for collecting monitoring information, presents the following at the time of the call (bid announcement), discusses it with private businesses by the time the PFI project contract is concluded and finalizes it by making an agreement:

- Required service level and judgement criteria for monitoring (targets)
- The overall monitoring framework and system, and the division of monitoring roles between the public and private sectors (including risk and cost burden)
- How to perform measurements, observations, records, reports, etc. during monitoring
- How to pay service consideration
- How to address services that fail to meet a required level

In the PFI project, the administrator, etc. requests for proposal on the contents of public services based on performance-based ordering. The administrator, etc. may also request for proposal on

measurements, observations, records, reports, etc. for the purpose of monitoring suitable for the service contents proposed by the private business.

5. Discussion Based on Monitoring Results

Since the monitoring results are directly linked to the payment of service consideration, a PFI project contract should be so formulated that there will be no dispute over the interpretation of the provisions on monitoring, etc.

The provision on discussion, etc. in the event of a dispute should be also included in the PFI project contract.

* Article 4.4 (10) of the Basic Policy

Any doubt may arise about the interpretation of the project contract or its provisions or any dispute regarding matters not stipulated in the project contract. Procedures and other measures to resolve such doubt or dispute should be provided concretely and clearly in advance, according to the type of the selected project.

6. About Various Reports, etc.

(1) The final responsibility for evaluating the measurement results for monitoring, etc. lies in the administrator, etc. However, it should be noted that excessive request to the appointed business to report beyond the contractual obligations not only constitutes a breach of the contract but also imposes a heavy burden on the appointed business.

The appointed business may digitize the service contents and the self-audited information recorded daily in the format as required by the contract. This is an effective means of reporting and facilitates data sharing with the administrator, etc.

It is also meaningful to hold discussions based on the digitalized information obtained above and to exchange information on the topics, such as improvement proposals to maintain the service level, proposals to improve efficiency, etc.

(2) Depending on the business performance of the appointed business, the reporting contents may be changed as appropriate, for example, increase or decrease in the number of reported items or the reporting frequency. This will motivate the appointed business more.

III. Measures Taken When Appropriate Public Services Are Not Provided

1. Ensuring Performance When Appropriate Public Services Are Not Provided (Default)

If the public services provided by the appointed business fail to conform to the PFI project contract, etc. and are inappropriate in that the state of default occurs, it must be improved to secure proper performance.

If this happens under a normal contract, the administrator, etc. would notify the appointed business of the situation, urge to conduct performance properly, and cancel the contract if the situation is not rectified.

In the case of PFI project contract, the original purpose of the contract is to continuously provide an appropriate level of services. If the appointed business has an intention to rectify the situation and continuing the project is rational, a system that rectifies the situation and improves its performance is needed. To make it happen, to give an economic motivation, such as reservation of or reducing the payment of service consideration, may be an effective method to promote performance obligation. It should be noted that cancellation of the contract is the last resort for the administrator, etc.

If the reduction of service consideration (including reservation of payment), correction notice, contract cancellation, etc. are to be provided as measures, etc. to ensure a proper and reliable provision of public services, these measures should be taken into consideration while keeping the following points in mind.

[1] The provision of service consideration reduction must be included as an economic motivation to encourage appropriate improvement. If the service consideration reduction is intended to secure appropriate services, a certain improvement period may be determined as necessary.

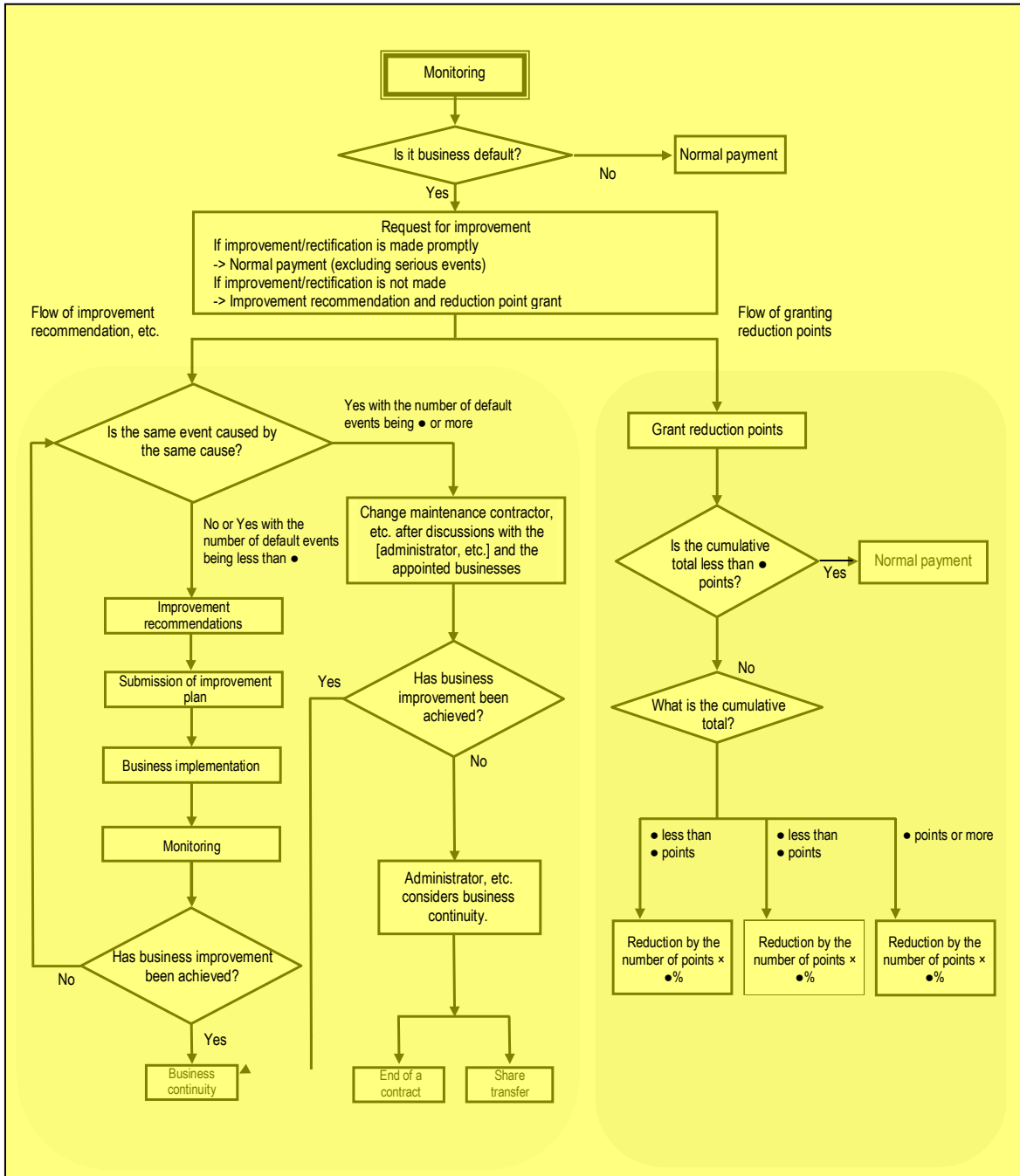
[2] It should be noted that some service consideration reduction system may deteriorate the financial situation of the appointed business in a short period of time, precluding the achievement of the service level required by the administrator, etc.

For example, instead of reducing the service consideration immediately, a penalty point system or a recovery point system may be used to maintain or improve the level of public services. The penalty point system grants reduction points according to the status of default and reduces the service consideration when the number of points reaches a certain level. The recovery point system is a system in which recovery points are given when the appointed business provides public services above the required level, and can be offset with the reduction points.

[3] Based on the basic principle of respecting autonomy and ingenuity of private business, there should be a scheme that allows the appointed business to improve its default under its own responsibility when it is recognized. The procedure for this scheme should be clarified in advance.

[4] Reasons for default should be clarified and the procedure taken by the administrator, etc. and appointed business should be provided in the PFI project contract.

The following flow chart shows an example of the procedure for handling defaults.



* For details on the handling, refer to “Monitoring Standards (Template).”

* The above flow chart shows an example of PFI projects of service purchase type. In reality, the flow chart is created by considering the content and characteristics of the project.

2. How to Reduce Service Consideration

In order to build a system to avoid default, the administrator, etc. needs to consider a scheme to ensure performance according to each project, and establish a service consideration reduction system as needed.

When building a service consideration reduction system, it should be considered for each project while keeping the following in mind:

- [1] What elements constituting the service consideration are to be reduced?
- [2] What do you measure before reducing the service consideration and why do you measure it?
- [3] How much do you reduce the service consideration?
- [4] Do you provide mitigation measures, such as postponement or reservation of reduction measures?
- [5] How do you relate the reduction measures to other measures, such as contract cancellation?

(1) Service consideration and payment method

The decision of service consideration and its payment method have critical implications for monitoring by the administrator, etc. on whether the level of public services provided by the selected project meets the predetermined required level or not.

The methods for determining a specific service consideration based on the contract are roughly divided into the following two types:

- [1] For each service, the main expenses involving the installment payment amount corresponding to the facility construction cost for the service, maintenance cost, and operation service cost, etc. are evaluated, a necessary reduction is made based on the evaluation results and the service consideration payment is made.
- [2] Instead of adding up cost for each service, the provided services are regarded as one, the unitary service is evaluated for its service level in terms of facility availability and service performance based on the judgment criteria, a necessary reduction is made based on the evaluation results and the service consideration is paid (called “unitary payment”).

These are the methods for determining the service consideration from the perspective of payment targets and variability of service consideration.

(2) Degree of service consideration reduction

The reduction in service consideration may impair the service provision itself, etc. In considering reductions, the administrator, etc. should pay adequate attention to a rapid deterioration of the appointed business's financial situation while balancing the service consideration reduction with other measures taken against the appointed business to prevent an adverse impact.

When deciding on a reduction, the administrator, etc. should check whether the judgment criteria stipulated in the required level documents, etc. are met, taking into consideration the severity of the required level of each service. For example, each service subject to service consideration reduction is weighed according to the severity and impact of not being able to receive the service, points corresponding to the weighing are added, and the service consideration is reduced when the added points exceed a certain level. Alternatively, each service in the entire project may be weighed and the service consideration for un-serviced periods, etc. may be reduced.

* In case of repeated default or false report, a provision of increasing the reduction by a certain rate, etc. may be included.

(3) Improvement period

In the event of default, the administrator, etc. should allow a certain period for improving the services instead of imposing financial penalties, such as service consideration reduction, immediately. If the appointed business takes corrective measures within the provided period and achieves the required level, service consideration will not be subject to reduction.

By setting an improvement period that reflects the severity of service content, the administrator, etc. can have the appointed business take corrective measures based on a stronger economic motivation.

(4) Payment reservation

If a certain required business level is not met, the administrator, etc. may provide an economic motivation by reservation of the payment of a certain part of service consideration for a certain period of time.

3. Other

(1) Points to be noted for methods, etc. of reducing service consideration

The following points should also be noted when constructing a system to avoid default, such as service consideration reduction.

[1] When appropriate public services are not provided, the administrator, etc. may determine measures to ensure performance. However, failing to properly coordinate these performance ensuring measures adversely affects the continued implementation of the PFI project itself. So, it is useful for the administrator, etc. to consider and understand how much the overall system will have an economic impact on appointed businesses.

[2] The administrator, etc. should regard the service consideration corresponding to the facility construction cost after transferring the facility ownership to the administrator, etc. by the Build Transfer and Operate (BTO) method as a finalized debt, which is separated from the service consideration for operating the facility. The reduction of service consideration is a measure to encourage the fulfillment of obligations, and the finalized debt should not be subject to service consideration reduction due to default. To make the appointed business bear the damage incurred by the administrator, etc. due to its default, a provision may be included that offsets the finalized debt with the amount of damage compensation.

[3] If the cause of a failure to reach the required business level lies in a subcontractor of the appointed business, administrator, etc. may provide replacement of such subcontractor as a measure against the failure to provide appropriate public services. However, replacing or guiding the subcontractor to improve its business should be carried out at the responsibility (risk) of the appointed business. Instead of directly requesting the appointed business to replace the subcontractor, the administrator, etc. should consider measures to encourage it to do so. However, if the administrator, etc. is statutorily involved in the business of the subcontractor, the administrator, etc. may set forth a provision requiring the appointed business to replace the subcontractor in question.

(2) Points to be noted for stand-alone-type projects (right to operate the public facility, etc. procedures, etc.)

In the case of stand-alone-type projects (right to operate the public facility, etc. procedures, etc.), there is no payment of service consideration from the administrator, etc., so no economic penalty, such as

service compensation reduction, can be imposed. However, collecting money may have the same effect as the penalty. In that case, the penalty should be determined after fully considering the characteristics of the project (substitutability, project profitability, etc.).

IV. Measurement Indicators Required for Monitoring

The required level documents, etc. provide the level of services requested by the administrator, etc. for the construction including design, maintenance, and operation of the facility, and provide the content of the business that the appointed business bears as a contract obligation. The act of measuring and evaluating this performance status is to conduct monitoring. By linking monitoring results to service consideration payments, the administrator, etc. can effectively and efficiently monitor service provision and manage the selected project based on the contract.

However, the requirement levels listed in the required level documents, etc. include those that can be measured and those that cannot be measured directly.

Accordingly, the administrator, etc. preliminarily shows the measurement indicators that meet the following requirements together with the required level for each service, and if the measurement indicators are met, the administrator, etc. can determine that the service meets the required level.

Measurement indicator requirements

- Measurable (quantifiable)
- Recordable
- Concise and clear
- Rational

* The measurement indicators are directly linked to payments to the private business. Any discrepancy in interpretation should be resolved by the time the PFI project contract is concluded so that the public and private sectors will not dispute over interpreting them.

It can be difficult to create measurement indicators for all requirements listed in the required level documents, etc. Depending on the project, it may be sufficient to determine major measurement indicators. The administrator, etc. should actually indicate measurement indicators within the range deemed necessary.

The measurement indicators of the service level include service performance-based ones and usability-based ones. The service performance-based ones measure the degree to which the service meets the required business level predetermined for each service (maintenance and operation). The usability-based ones indicate whether the facility constructed under the PFI project contract is maintained in a usable state.

* Example of service performance-based measurement indicators: Number of books lent from a library

* Example of usability-based measurement indicators: [1] Whether a facility operates normally (air conditioning in the office, automatic door in the lobby, automatic payment machine at parking lots), [2] Whether the prescribed criteria are met (surgery room cleanliness class, museum temperature and humidity)

V. Understanding the Financial Situation

The administrator, etc. should confirm that the appointed business is in a financial situation capable of providing public services continuously in a stable manner to ensure the required level of public services and business continually.

Specifically, the administrator, etc. checks the audited financial statements submitted by the appointed business on a regular basis for any events or factors that may hinder the sound operation of the selected project. If any event occurs that could have a significant adverse impact on the implementation of the selected project, the administrator, etc. asks the appointed business to submit additional financial data, reports on specific matters, explain the situation or conduct surveys by experts as necessary.

If any factor is found that hinders the securing of the required level of public services, the administrator, etc. should consider and take preliminary measures for the expected situation.

If a project involving the parallel establishment and utilization of a profitable facility adopts a consolidated accounting method, understanding the financial situation of the entire business is important.

* Article 4.4 (3) of Basic Policy

“To ensure the provision of appropriate public services while keeping it in mind to minimize his/her involvement in private businesses, the administrator, etc. of the public facility, etc. shall take into consideration the following matters and agree on them in the project contract.”

(c) The administrator, etc. of the public facility, etc. can request the appointed business to submit a report on the financial situation that may affect the implementation of the selected project audited by a certified public accountant, etc. on a regular basis.

(d) In the event of a situation that may have a serious adverse impact on the implementation of the selected project, the administrator, etc. of the public facility, etc. can request the appointed business to submit a report on the status and further conduct a survey by a third-party expert and submit a survey report.

* If the appointed business procures funds by the project finance method and has a difficult financial situation, it violates the financial covenant in the loan agreement and may trigger a system to rectify the problem. Such a loan agreement, if concluded, allows the financial institution to monitor the project and will produce a certain effect although the purpose of the financial institution is different from that of the administrator, etc.

The following paragraphs summarize key points for analyzing and evaluating financial statements, etc. conducted by the private sector:

* For reference

[1] Audit report: Check the following points from the audit results and auditor's findings:

- i) Is the accounting procedure appropriate?
- ii) Is there any contingent debt, off-balance-sheet debt, etc. that threaten financial soundness?
- iii) Are there any abnormalities that threaten the continual implementation of the project?

[2] Balance sheet: Check the following points:

- i) Are there any figures in each item of assets, liabilities and net assets that deviate significantly from the originally planned values?
- ii) Are there any accounts or assets and liability items that are not related to the project or the approved annex project?
- iii) Has the capital payment scheduled in the basic agreement, etc. been completed? Are there any changes to the capital structure?
- iv) Are there any abnormal values in the notes?
- v) If there is any large change in assets/liabilities from the previous quarter, what is the reason?

vi) If there are no abnormal values in financial indicators, such as current ratio and debt ratio, or if there is any large change from the previous quarter, what is the reason?

[3] Income statement: Check the following points:

- i) Are there any figures in the revenue/expense items that deviate significantly from the originally planned values, and if so, what is the reason?
- ii) Is it possible to secure the appropriate profit margin initially assumed?
- iii) Are there any abnormal values in the extraordinary profit/loss items?

[4] Cash flow statement: Check the following points:

- i) Is the operating cash flow maintained at a positive level?
- ii) Is the investment cash flow reasonable according to the facility development plan?
- iii) Does the financial cash flow deviate from the initial plan?

[5] Statement of appropriation of retained earnings: Check if the outflow amount is within the appropriate range.

[6] Appendix to financial statements: Referenced when conducting a detailed study in response to [1] to [5] above.

[7] Tax return: Understand the factors that affect the continual implementation of the project based on the differences between corporate accounting and tax accounting.

[8] Statement of cash receipts and disbursement: Analyzed when the appointed business has a problem with the cash balance, but the frequency of analysis (monthly, quarterly, semi-annual, annual, etc.) should be determined as needed.

VI. Others

1. Perspectives for Responding to Medium- to Long-term Problems

Since a PFI project has a long project period, the required service level needs to be changed according to the demands of the time, and the cost factors required for service provision may vary significantly due to price fluctuations from inflation or the obsolescence of adopted technology.

For this reason, it is beneficial for the public and private sectors to build a system that can change the service consideration to be paid and the payment method or required service level in response to such changes in the situation, and provide such system in the PFI project contract.

Some projects contractually provide the revision of service consideration in response to price fluctuations by adopting an index that accurately reflects the market prices of resources and services actually used by the appointed business. However, even with such an index, service consideration may no longer reflect the actual state of the market over the time.

To deal with this problem, the following means for correcting the deviation from the market are available: Benchmarking tests and market tests:

[1] Benchmarking test

Method for revising the required level or price of a specific service if a deviation is found at a certain level after comparing the level (service level or price) of the service with the average level of the services of the same type in the general market at that time.

* If the appointed business wants to change the required level, the PFI project contract must be changed first.

[2] Market test

Method for revising the required level or price of a service by changing the subcontractor, etc. that actually provides the service through re-bidding conducted by the appointed business if the revision of the required level and price of the service is deemed necessary as a result of the benchmarking test.

* The market test itself may be performed without the benchmarking test, but is actually used only in a limited way because changing the subcontractor is expected to cause a difficult situation, such as a non-service period.

During the project period, it may be found that the initially assumed monitoring criteria no longer function properly because of the actual state of the project or that more appropriate other criteria can be considered. In such cases, the administrator, etc. or the appointed business may propose to revise the original criteria with justifiable reasons. At this time, the administrator, etc. and the appointed business (including third parties, such as academic experts, if necessary) discuss the reasonability of the new proposals and determine new judgment criteria if the revision is deemed necessary. If the newly adopted judgment criteria require changes to the required level, the PFI project contract is also revised.

2. Publication of the Results of Monitoring, etc.

(1) Evaluation of monitoring, etc.

The administrator, etc. and third parties, such as academic experts (if necessary) will evaluate whether the appointed business is carrying out operations properly and reliably and whether the level of public services is being improved based on the results of monitoring, etc. Depending on the evaluation results, the administrator, etc. should encourage the appointed business to improve its operations.

For that purpose, the administrator, etc. needs to discuss with the appointed business for business improvement on the basis of issues identified in the monitoring. It is also crucial for the administrator, etc. to evaluate properly the good efforts of the appointed business by introducing a system (reward money, award system, etc.) to more motivate the appointed business.

(2) Publication of the results of monitoring, etc.

The basic policy of the PFI project also states that "transparency must be ensured throughout the entire process from the proposal of a qualified project to its end (the principle of transparency)." The administrator, etc. needs to proactively announce the results of monitoring, etc. to local residents, etc. in order to ensure transparency of implementation of the selected project. Publishing the monitoring results is also needed to motivate the appointed business to work. However, disclosing some matters may harm the rights of the private business, competitive position, and other legitimate interests. These matters should be excluded from the disclosure after making a prior agreement in the PFI project contract, etc.

Supplementary Provisions

This guideline will come into effect from October 23, 2018.