Better Business Cases

Guide to Developing the Detailed Business Case

30 September 2015

THE TREASURY
Kaitohutohu Kaupapa Rawa

New Zealand Government

Acknowledgements

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The Five Case Model is the best practice standard recommended by the HM Treasury for the preparation of business cases. The New Zealand Treasury wishes to acknowledge that the following documents were used and adapted for the purpose of creating this guidance:

- 'Making Sense of Public Sector investments' (2001) by Courtney A Smith and Joe Flanagan;
- the Green Book at www.gov.uk/government/publications/the-green-book-appraisal-and-evaluation-in-central-governent; and
- 'Delivering Public Value from Spending Proposals: Green Book Guidance on Public Sector Business Cases using the Five Case Model' at www.wales.gov.uk/funding/wiipindex/5cmodel/?lang=en.

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The URL for this document on the Treasury's website at September 2015 is http://www.treasury.govt.nz/statesector/investmentmanagement/plan/bbc/guidance

The Persistent URL for this document is http://purl.oclc.org/nzt/g-bbcdbc

Contents

About this Guidance

This guidance is intended to assist developers and reviewers to build better business cases using the Five Case Model, the New Zealand Government's accepted good practice standard.

This guidance document is intended to assist investors, senior responsible owners, workshop facilitators and business case developers to prepare the Detailed Business Case. This document has been written as part of the suite of Better Business Case guidance. It is part of a comprehensive and structured tool-kit of guides and templates to assist you at every stage of the business case development. This guidance can assist you whether you are considering an investment in change at the portfolio, programme or project level in either the public or the private sectors.

This guidance also provides a useful reference for business managers, project or programme managers, and other stakeholders who can either influence investment decisions or have an interest in the successful delivery of change.

The guidance outlined in this document applies until this document is updated or replaced.

What this Guidance is Not

This guidance is not intended to comprehensively cover all the related aspects of business case development (although the guidance describes where other relevant guidance fits). These may include regulatory impact, economic assessment, procurement, risk management, Public Private Partnership (PPP), Treaty, programme/project management or assurance processes. You should refer to any relevant policies, rules, expectations and practices that apply to your specific organisation or sector.

Key Changes to this Guidance from the Previous Version

The key changes to this guidance from the version dated 28 February are:

- being clearer on what's expected and the suggested evidence
- bringing a principle based approach to the use of methods and tools in gathering the evidence needed to develop the business case
- giving greater clarity of the relationship between strategy, policy and programmes
- showing different ways of designing and delivering programmes and projects, in conjunction with the GCIO
- providing greater clarity on how each type of business case supports what types of decisions in the Governments annual budget process
- incorporating recent changes to the NZ Government Procurement guidance, including early market engagement, and
- replacing multiple scoping documents into one point of entry form to agree the business case approach.

Questions and Feedback

General enquiries about the information contained in this guidance, not addressed in this guidance, can be directed to betterbusinesscases@treasury.govt.nz.

For Government agencies, any agency-specific questions should be addressed to your Treasury Vote team.

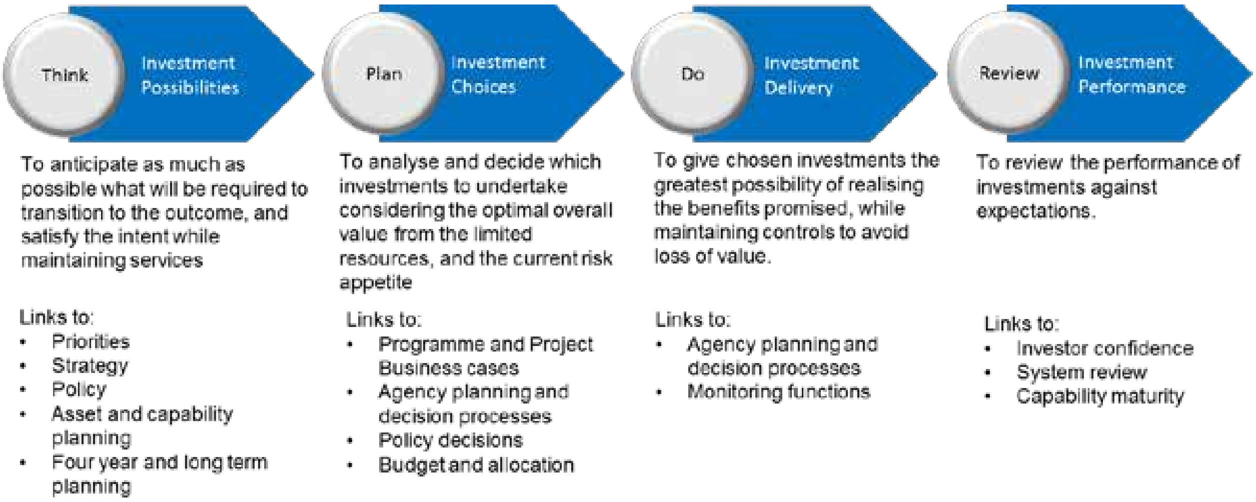
Any comments as to how we could improve this guidance can be directed to guidance@treasury.govt.nz.

Further Information

This document is part of the Better Business Cases suite of guidance available at the Treasury website http://www.treasury.govt.nz/statesector/investmentmanagement/plan/bbc

The Investment Management Lifecycle

Government's investment life cycle is made up of four phases: think, plan, do and review. Together these create an ongoing dynamic as ideas are tested, refined and adopted or discarded within an agency and across government. Each phase has different implications for agencies and decision makers.



The Plan phase examines how to translate the Think to the Do. A business case is the vehicle to demonstrate that a proposed investment is strategically aligned, represents value for money, and is achievable. A business case turns an idea (think) into a proposal (plan). It enables decision makers to invest with confidence knowing that they have the best information available at a point in time. It is also a reference point during the "Do" phase to support delivery, and used in the "Review" phase to determine whether the benefits in the business case were realised. For more guidance on managing benefits from programmes and projects please see [Managing Benefits from Projects and Programmes: Guide for Practitioners (384 KB)]

BBC should be used in a fit for purpose way

BBC has been developed so it can be used in a fit for purpose way no matter the nature of programme or project and the associated scale, risk and uncertainty.Eddie Obeng was one of the first to provide a useful way to look at managing projects that had differing degrees of uncertainty and ambiguity. In essence there are two axes to be considered. How much do I know about **what** I am trying to? And How much do I know about **how** I am trying to do it?

The differences between Programme and Project Business Cases

Programme Business Cases

Major investments that comprise of a set of related projects and activities will typically require a programme business case. Programmes are about managing change with a strategic vision and a roadmap of how to get there. They are able to deal with uncertainty and complex inter-relationships in a dynamic environment by being flexible.

Programmes typically comprise a number of related projects and activities that will be completed in several tranches over an extended period to achieve outcomes that are greater than sum of the parts. Examples of different types of change may be delivered by a programme are:

- Policy change focussed on changes and improvements in society, driven by desired outcomes but likely to be ambiguous and complex to define in terms of what it involves.
- Fundamentally changing the way an organisation works – led by a vision of the outcomes and the benefits; typically some uncertainty about the change but clear delivery approaches can be used.
- A highly complex, lengthy project that is best broken down into a series of related projects and managed as a programme.

Project Business Cases

In contrast to a programme, a project is a set of interrelated tasks to be executed over a fixed period to achieve a set of objectives.

For significant projects, there are two key stages in the evolution of a project business case being the indicative business case and the detailed business case. For smaller and/or lower risk investments typically a single stage business case (which combines the indicative and detailed business cases) is used.

The Business Case Framework

The primary objective of BBC is to enable smart investment decisions for public value. If applied appropriately BBC can also help to:

- reduce the costs of developing business cases
- reduce the time it takes to develop business cases, and
- meet recognised good practice.

BBC is a common language and provides a systematic way for stakeholders to think and work together to give decision makers the information they need to invest with confidence.

Further information about the BBC framework is available on the Treasury's investment management website, at:
http://www.treasury.govt.nz/statesector/investmentmanagement/plan

We support senior responsible owners (ie, sponsors), business case developers and reviewers by providing:

- BBC Guidance
- Methods (and tools) to develop business cases
- Access to BBC Training
- Access to Endorsed BBC Experts
- BBC Clinics for Investment Intensive Agencies

We encourage organisations to further build their business case capability by accessing training and using endorsed BBC Experts.

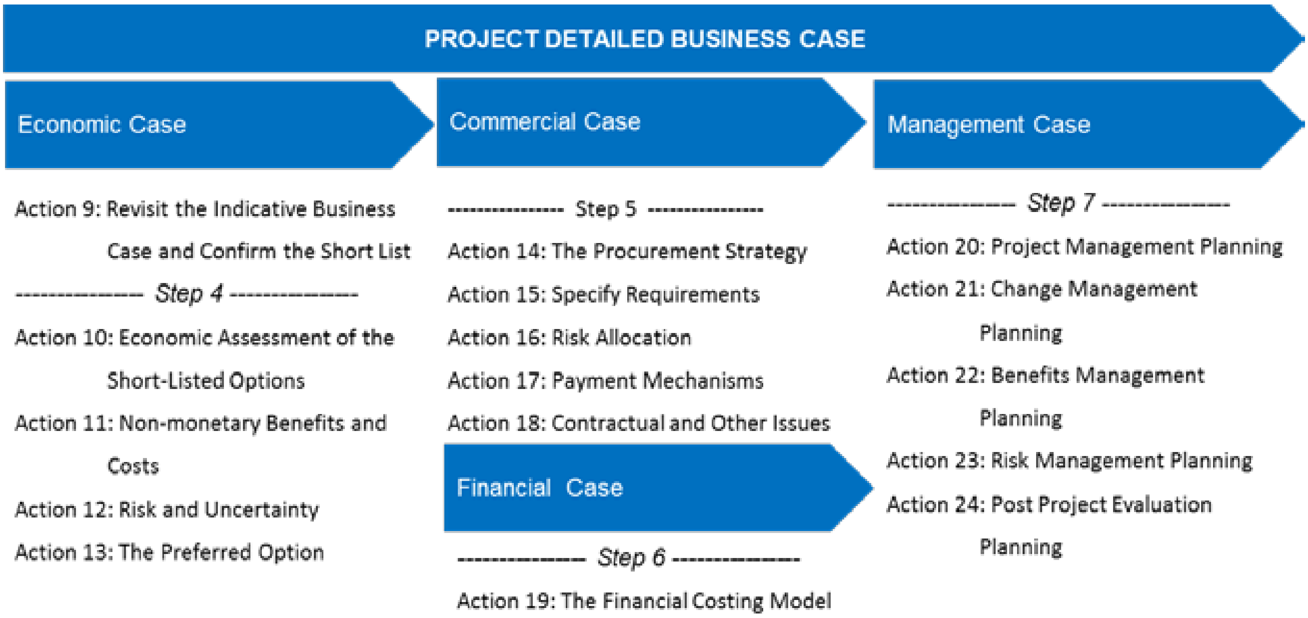
We suggest the senior responsible owner (ie, sponsor), use the Point of entry document to agree the approach, including the methods (and tools) and effort with the reviewer. In the State Sector, investment intensive agencies can engage with the Corporate Centre to secure this agreement through business case clinics.

To ensure we are achieving our objectives we regularly evaluate the BBC approach to identify improvements. A summary of the most recent business case evaluation is available on our website.

The Detailed Business Case

Purpose of a Detailed Business Case

The Detailed Business Case recommends a preferred option that optimises value for money and seeks approval from decision-makers to finalise the arrangements for successful implementation. It is developed using the 4th to 7th steps as set out below.



The decision to develop the Detailed Business Case typically follows from the previous Indicative Business Case recommendation to proceed with the preferred way forward.

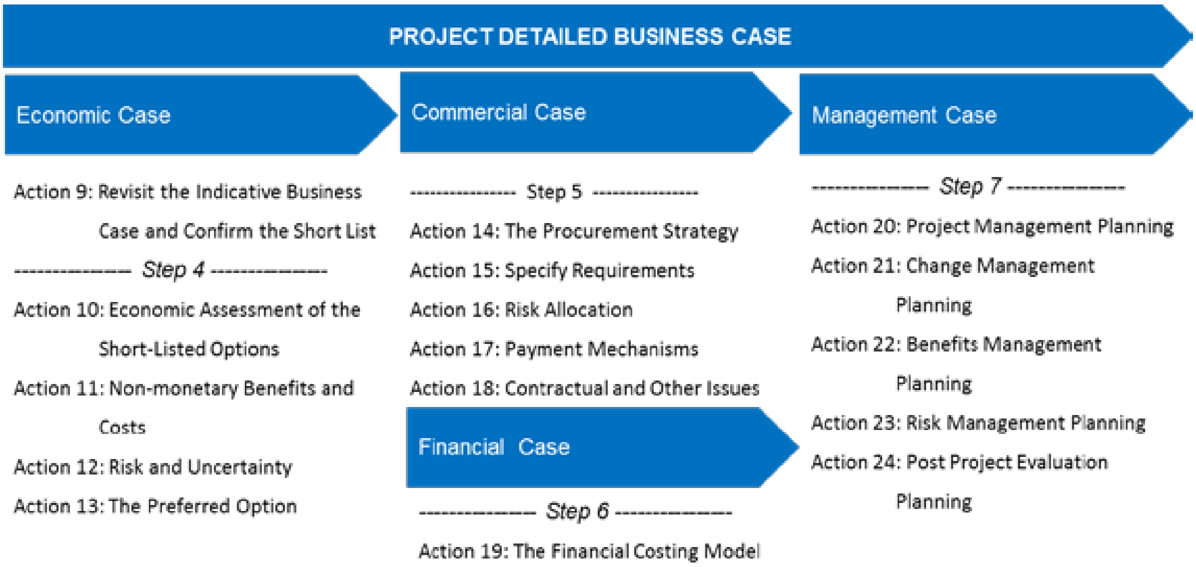
The Detailed Business Case:

- revisits and confirms the strategic case developed in the Indicative Business Case
- identifies the preferred option which optimises value for money, by undertaking a more detailed analysis of the costs, benefits and risks of the short-listed options
- prepares the proposal for procurement
- plans the necessary funding and management arrangements for the successful delivery of the project, and
- informs a proposal to decision-makers to seek agreement to approach the market and finalise the arrangements for implementation of the project. Apart from proposals that are likely to result in a non-traditional procurement[1], a Request for Proposal (RFP) may be issued once approval is granted.

[1] Refer to the PPP guidance maintained by the Treasury and available from http://www.infrastructure.govt.nz/publications/pppguidance.

Detailed Business Case Steps and Actions

The detailed business case, Steps 4 to 7 of the business case framework, is developed using Actions 9 to 24 as shown below. Please refer to Annex A for an overview of all of the 34 BBC actions.



The remainder of this guidance is structured around each action by the applicable Case. The purpose of each action is described together with what is specifically required and what evidence should be provided. It also contains tips and examples to assist business case developers.

Private Public Partnerships (PPPs)

Where a non-traditional procurement option such as PPP procurement has been short-listed as part of the Indicative Business Case, additional analysis is required in relation to a number of the above actions. For further information, refer to the supplementary guidance attached as Annex Five to this guide.

Suggested methods and tools

There are a variety of methods and tools that can be used in the development of the business case. When considering the approach to be used, developers should consider the methods (and tools) that they will use. Reviewers will consider whether the methods (and tools) are suitable, proven, inclusive, and capability should exist to apply it.

Some suggested methods can be found at http://www.treasury.govt.nz/statesector/investmentmanagement/plan

Revisiting the Strategic and Economic Cases

Action 9: Revisit the Indicative Business Case and Confirm the Short List

Purpose

The purpose of this action is to revisit, and either confirm or update, both the case for change and the short-listed options recommended for further consideration in this Detailed Business Case.

What's expected?

The previous analysis and conclusions as part of the Indicative Business Case should be revisited and updated, where necessary. This is because a considerable amount of time may have passed since the initial analysis and the political, economic and policy environment may have significantly changed.

Revisit the strategic case

Review the case for change should be reviewed to ensure that:

- the investment objectives and planning assumptions still valid
- any outstanding differences at Indicative Business Case stage between stakeholders and customers been satisfactorily resolved
- any conditions made as part the earlier approval of the Indicative Business Case have been satisfactory resolved.

Review the economic case

Review and refine earlier work on the long-list and the preferred way forward. The recommended short-list contained in the Indicative Business Case should be confirmed to ensure that they are:

- likely to deliver the investment objectives and critical success factors
- likely to deliver sufficient benefits and deliver value for money
- still considered to be realistic and achievable.

Suggested evidence

The rationale for any significant changes or revisions should be clearly documented.

Economic Case – Determining Potential Value for Money

The Purpose of this Part of the Economic Case

The purpose of this part of the economic case is to undertake a more detailed analysis of the costs, benefits and risks of the short-listed options. This should provide a clear understanding of the value for money likely to be provided by the preferred option in delivering the required services. This includes:

- cost benefit analysis of the short-listed options
- assessment of any intangible benefits and costs, and
- assessment of risk and uncertainty.

The level of analysis should be scaled to the proposal

The level of analysis should be tailored to the relative size and risks of the proposal. The standard of analysis varies from a full economic cost benefit analysis to light financial analysis, depending on the scale and level of risk of the proposal. This is shown in the table below.

	Full Analysis	⟷	**Light Analysis**
Monetary benefits and costs	National economy	Organisation and selected sectors	Organisation
	All significant resource flows, including non-monetary costs and benefits		All significant resource flows that can be expressed in monetary terms
Non-monetary benefits and costs	Multi-criteria decision analysis using expert facilitation and proprietary tools	Multi-criteria decision analysis	Ranking of non-monetary benefits and costs
Uncertainty	Quantitative risk analysis	Quantify risks and probabilities[2]	Single point adjustments of costs and benefits

Not all proposals will require a full economic cost benefit analysis, a full multi-criteria analysis or quantitative risk analysis. Simpler forms of financial analysis may be appropriate for proposals that are organisation-specific and have minimal impacts on either other organisations, individuals or the wider economy. Examples may include the impacts of a new accounting package or a lease versus buy decision for property.

Prior to commencing development work consider using the Point of entry document http://www.treasury.govt.nz/statesector/investmentmanagement/plan/bbc/guidance/bbc-invest-proposal.pdf (38 KB) to agree the approach and effort with the reviewer. In the State Sector, investment intensive agencies (http://www.treasury.govt.nz/statesector/investment-intensive-agencies) can engage with the Corporate Centre to secure this agreement through clinics (http://www.treasury.govt.nz/statesector/investmentmanagement/plan/bbc/clinics).

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2 Consider risk modelling techniques that are less resource intensive than full quantitative risk analysis. For example, by using multi-point probability or decision-tree analysis to estimate the impacts of different outcomes on mid-point risk estimates.

Action 10: Economic Assessment of the Short-Listed Options

Purpose

The purpose of this action is to undertake an economic assessment of the Short-Listed options to inform the recommendation of a preferred option in Action 13.

What's expected?

An economic assessment seeks to capture all benefits and costs regardless of to whom they accrue. Economic assessments also take into account costs and benefits that may not be reflected in monetary transactions. An economic benefit is considered to be any gain in the welfare of society arising from the investment proposal. For example, it can include the time savings from reduced travelling times on a new motorway or the increase in quality of life years remaining as a result of a new pharmaceutical treatment. Different stakeholder groups derive different benefits (and dis-benefits) from an investment proposal and will have different perspectives on the value added.

Undertaking economic assessment of the short-list options involves the following steps:

a. Establish the assumptions and scope underlying the analysis.

b. Determine an appropriate period for the analysis. This appraisal period typically matches the economic life of any proposed asset. In some cases it may be determined by the contractual term of the services. Where options have differing economic lives, a single common appraisal period is required. Either residual values can be assumed for the longer term options or reinvestment of shorter term options.

c. Identify all significant monetary benefits and costs. The monetary and non-monetary benefits in Action five can be revisited and updated. All material direct and indirect, monetary and non-monetary costs should be included. Indirect costs as a result of the outcomes of the proposal may be incurred by the organisation, other agencies, users and other affected stakeholders.

d. Assign monetary values to the benefits and costs, wherever possible. All monetary estimates should be expressed in current dollar terms. GST, depreciation, capital charges and financing costs are also typically excluded.

e. Discount the benefits and costs to present values using the appropriate Public Sector Discount Rate as specified by the Treasury.[3] Where a different discount rate is proposed, this should be tested as part of the Point of Entry Document discussion.

Suggested evidence

The approach and basis that has been used should be described including the collection of key assumptions and the involvement of key stakeholders.

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[3] Refer to the Public Sector discount rates published on the Treasury website at http://www.treasury.govt.nz/publications/guidance/planning/costbenefitanalysis

Action 11: Non-monetary Benefits and Costs

Purpose

The purpose of this action is to assess the non-monetary benefits and costs of the Short-Listed options to inform the recommendation of a preferred option in Action 13.

What's expected?

Non-monetary benefits and costs can influence the choice of the preferred option. They should be explicitly highlighted and explained in the analysis so that decision-makers are aware of the value judgements and trade-offs involved in pursuing a particular option. This explanation can be quantitative, qualitative, descriptive, or a combination of these.

Suggested evidence

The approach and basis that has been used should be described including the collection of key assumptions and the involvement of key stakeholders.

Action 12: Risk and Uncertainty

Purpose

The purpose of this action is to assess the risk and uncertainty of the Short-Listed options to inform the recommendation of a preferred option in Action 13.

What's expected

All estimated benefits, costs and timeframes are subject to risk and uncertainty which can influence the choice of the preferred option. Given the choice between two competing short-listed options with similar estimated costs and benefits, a decision-maker will more likely prefer the option that provides greater certainty of costs, benefits and timings of key deliverables.

It is recommended that all significant risks should be measured and quantified (in monetary terms) as early as possible. The risks initially identified by stakeholders in action five should be revisited and re-evaluated.

Suggested evidence

Demonstration that risks and uncertainty of the short-listed options have measured and quantified using an appropriate method.

Methods and tools to help

There are a number of techniques can be used to quantify risk and uncertainty including Optimism basis, Single-point probability analysis, and Quantitative risk analysis (QRA). A description of these techniques can be found at Annex Two. A QRA of costs is mandatory as part of the development of a Detailed Business Case (DBC) for high risk major projects or programmes monitored by the Treasury.

Action 13: The Preferred Option

Purpose

The purpose of this action is to identify the preferred option and test its robustness using sensitivity analysis. The overall objective is to determine which of the short-listed options is likely to provide the best value for money (the optimal mix of benefits, costs and risks).

What's expected?

Identify the preferred option

If an economic cost benefit analysis has been undertaken across all benefit and cost areas then the best option is likely to be the one with the highest, risk adjusted, net present value[4].

Where non-monetary benefits and costs are significant, these will influence the choice of the preferred option.

Decision-makers will need to be provided with a basis to inform trade-offs between competing short-listed options with different mixes of monetary and non-monetary benefits and costs.

An example of presenting combined cost benefit analysis and multi-criteria decision analysis

In this example decision makers need to consider the potential for the higher non-monetary benefits of option three to out-weigh the extra monetary net benefits of option four.

	Note	Option 1:Do Nothing	Option 2: Do Minimum	Option 3: Less Ambitious	Option 4: Preferred Way Forward	Option 5: More Ambitious
Analysis Period (years)		20	20	20	20	20
Capital Costs ($m)		$0.0	$22.5	$23.9	$31.6	$45.7
Whole of Life Costs ($m)		$14.4	$34.2	$49.7	$70.7	$90.9
Cost-Benefit Analysis of monetary costs and benefits at the Public Sector Discount Rate						
Present Value of Benefits ($m)		$2	$25	$75	$115	$126
Present Value of Costs ($m)		$7	$23	$40	$52	$73
Benefit Cost Ratio		0.3:1	1.1:1	1.9:1	2.2:1	1.7:1
Net Present Value (NPV, $m)		**($5)**	**$2**	**$35**	**$63**	**$53**
NPV Rank (out of 5)		**5**	**4**	**3**	**1**	**2**
Multi-Criteria Decision Analysis of non-monetary benefits and costs (score out of 10)						
Improved management information (20% weight)		5	7	8	6	6
Greater inter-agency collaboration (40% weight)		2	5	7	4	5
More competitive marketplace (40% weight)		0	5	5	5	4
MCDA Rank (out of 5)		**5**	**2**	**1**	**3=**	**3=**

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4 Using alternative measure, such as internal rate of return, equivalent annual cost, benefit-cost ratio and pay-back period methods may be desirable in certain cases.

Test the robustness of the preferred option

Test the robustness of the preferred option recommendation to changes in key assumptions and/or variables by using sensitivity analysis.

Sensitivity analysis examines how net present values, benefits, costs or other outcomes vary as individual assumptions or variables are changed. The sensitivity analysis needs to be well designed and clearly presented. The analysis should give a realistic picture of the extent to which the preferred option is still worthwhile pursuing even if there are significant changes in key variables.

The decision about which form of sensitivity analysis to undertake and the effort to invest should be made on a case-by-case basis, depending on the scale of the proposal, the degree of future uncertainty around key costs or benefits, and the risk tolerance of stakeholders.

Annex Three contains further guidance on the approaches that can be used to undertake sensitivity analysis.

Suggested evidence

The rationale for recommending the preferred option must be clear and evidence based. Sufficient evidence for the selection should be provided along with a clear audit trail for reviewers to check the assumptions, evidence and calculations leading up to the selection. Stakeholders and decision-makers should also be provided with assurance that the analysis is robust.

Commercial Case – Preparing for the Potential Deal

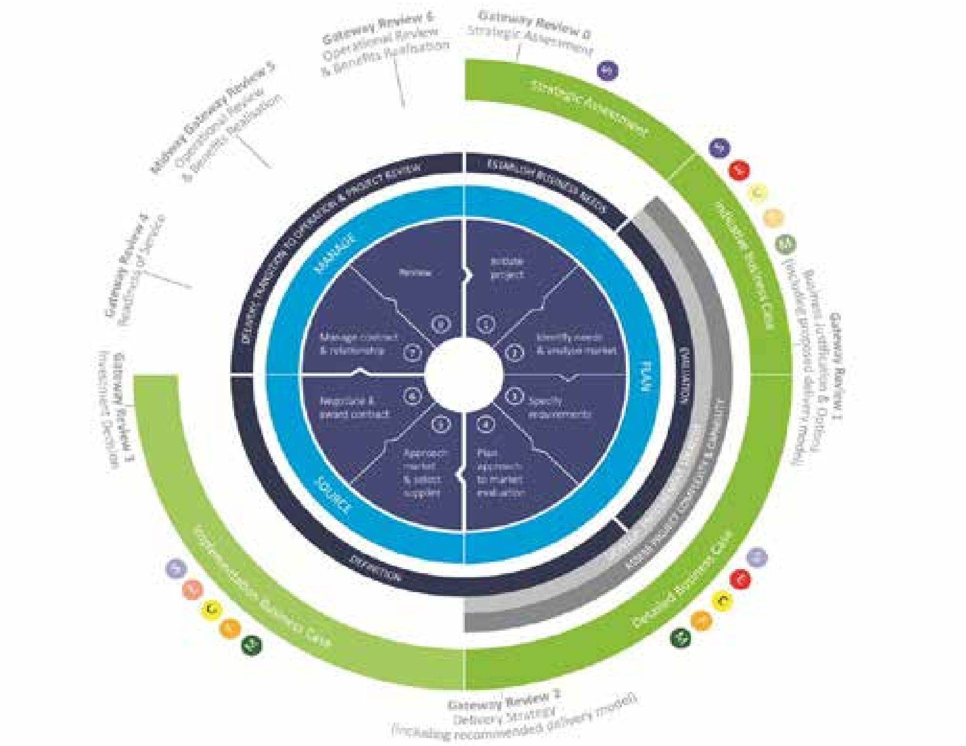
Purpose of this part of the commercial case

This part of the commercial case plans early for the procurement arrangements needed to implement the preferred solution, prior to issuing requests for proposals.

The procurement lifecycle

The procurement lifecycle is in three distinct phases: planning, sourcing and managing. These phases are further divided into eight distinct, but interrelated stages. The eight stage process is demonstrated in the following diagram and detailed further in *Mastering Procurement: A Structured Approach to Strategic Procurement (2014)*. [5]

The procurement lifecycle is presented as a series of consecutive stages from 1 to 8. In real life however, some stages can sometimes be done concurrently.



Action 14: The Procurement Strategy

Purpose

The purpose of this action is to develop a fit for purpose strategy for the procurement of services that are required.

What's expected?

The development of an appropriate procurement process and plan that is proportionate to the nature, size, complexity, value and risk of the service or product being procured.

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5 Refer to the Ministry of Business, Innovation and Employment website at http://www.business.govt.nz/procurement.

Where appropriate collaborative arrangements should be considered. These arrangements can be successful where the parties have shared interests and objectives and there is mutual trust, openness and transparency. Types of collaborative arrangements include Syndicated contracts, Common Capability contracts, and All-of-Government contracts.[6]

Compared to conventional purchasing arrangements, collaborative approaches can potentially provide greater flexibility and better value for money through improved economies of scale

Suggested evidence

Demonstration that:

- The procurement strategy for the successful delivery of the required services been considered and prepared in sufficient detail
- Alternative options are being considered

Methods and tools to help

For further details on preparing the procurement strategy and plan including links to the business case development process refer to *Mastering Procurement: A Structured Approach to Strategic Procurement (2011)*. Advice from an experienced procurement practitioner should be sought when developing the procurement strategy.

Action 15: Specify Requirements

Purpose

The purpose of this action is to specify the requirements for the service or asset to be procured.

What's expected?

For further details on the preparation of a specification requirements refer to *Mastering Procurement: A Structured Approach to Strategic Procurement* (2011).

Suggested evidence

A summary of the requirements and a description of the process that was used to identify and agree them

Action 16: Risk Allocation

Purpose

The purpose of this action is to consider how the risks may be balanced between the purchaser and the supplier(s).

What's expected?

Consideration of how commercial risks can be best managed. The key principle is to allocate risk to the party best able to manage the risk. Roles and responsibilities for management of each key risk need to be clearly defined. This is especially important when the successful delivery of the project is subject to significant risk.

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6 More information is available at http://www.business.govt.nz/procurement/all-of-government-contracts/collaborative-contracts

Suggested evidence

A summary of how commercial risks will be balanced between the purchaser and the supplier(s) and why this is appropriate.

Action 17: Payment Mechanisms

Purpose

The purpose is to define the mechanism(s) for the contracted services or products to be purchased.

What's expected?

Consideration of the expected pricing and payment mechanism. If it is properly constructed, the payment mechanism will incentivise the supplier to deliver services in accordance with the requirements of the procuring organisation.

The payment mechanism is the formula against which payment for the contracted services to be made. The underlying aim of the payment mechanism and pricing structure is to reflect the optimum balance between risk and return in the contract. The approach should be to relate the payment to the delivery of service outputs and the performance of the supplier.

Suggested evidence

Description of the intended pricing and payment mechanism and demonstration that this mechanism is appropriate.

Action 18: Contractual and Other Issues

Purpose

The purpose of this action is outline the intended contractual arrangements.

What's expected?

An appropriate form of contract between the organisation and the supplier will help to ensure high quality and cost effective outcomes.

Wherever possible, agencies should adopt a standard form of contract as appropriate for the procurement.

Suggested evidence

Outline the intended contractual arrangements including:

- *Form of contract and key contractual issues* - provide details of the type of contract that will best suit the nature of the procurement.
- *Ongoing contract management* – provide details of how the contract will be managed.
- *Accounting treatment* - provide details of the intended accounting treatment for the potential deal, including the relevant accounting standards.
- *Other implications* - identify any implications arising from the proposed investment. These can include implications for privacy (for information systems that hold or provide personal information), other legislative issues or Treaty of Waitangi issues.

Financial Case – Ascertaining Affordability and Funding Requirements

The Purpose of this Part of the Financial Case

The purpose of this part of the financial case is to determine the cost and revenue implications of the preferred option and plan the funding requirements, including driving value from existing finances.

The difference between the Economic and Financial Cases

The economic case focuses on assessing the **relative value for money** of alternative options. While the financial case focuses on the **affordability and funding implications** of the short-listed option for the organisation. The table below shows the differences between the economic and financial cases.

Characteristic	Economic Case	Financial Case
Focus	Value for money of short-listed options, relative to the base option	Affordability of the preferred option,
Scope	National economy	Organisation(s) only
	All resource flows, including non-monetary costs and benefits, over the appraisal period	Direct financial and accounting impacts, only over the period to steady state
	Indifferent between capital and operating	Capital and operating detailed separately
GST and taxes	Excluded	Excluded
Depreciation	Excluded	Included
Interest, financing costs and any capital charges	Excluded	Included
Transfer payments[7]	Excluded	Included
Sunk costs	Excluded	Excluded[8]

[7] Transfer payments are defined as payments for which no goods and services are obtained in return, for example social welfare benefits.

[8] Sunk costs are costs already incurred that cannot be recovered if the proposal does not proceed, hence they do not relate to the decision being sought. Some sunk costs may be relevant to the funding sought and should be captured in the financial costing, such as the costs of developing the proposal, the business case, assurance or any decommissioning costs..

Action 19: The Financial Costing Model

Purpose

The purpose of this action is to determining the affordability of the preferred option.

What's required?

Identify the funding required

For the preferred option, list all material financial expenditure and revenue items year by year over the operating life that was identified in Action 10 and identify the operating and capital funding that will be required. It is likely that accounting expertise will be required to assist with this analysis.

The table below is an example of the structure of the financial costing table for a hypothetical Crown and third party funded information technology project.

	000's				
Preferred Option	**Year 0**	**Year 1**	**Year 2**	**……..**	**Total**
Capital Expenditure: - Fixed assets - Software - Total Capital					
Operating Expenditure: - Personnel - Operating - Depreciation - Capital Charge - Total Operating					
Total Expenditure:					
Revenue: - Revenue Crown - Third Party Revenue					
Total Revenue:					
Capital funding required:					
Operating funding required:					

Assess affordability

Identify the sources of funding and consider any affordability gaps over the appraisal period, ie, the difference between the funding required in any year and funding available from other sources. Consider any required actions to close the gap such as adjusting the scope of the preferred option, phasing the implementation differently, negotiating preferred payments for services or finding additional sources of funding.

Also, consider the risks and uncertainties that could affect the affordability of the project. This analysis can be based on the risk and sensitivity analysis undertaken previously in actions 12 and 13.

The risks and uncertainties will vary from project to project, but some key questions to consider are:

- Would the preferred option still be affordable if actual costs were 10% higher than expected?
- What if expected savings were to fall by 10%?
- What circumstances might cause saving targets to be breached?
- What if other income to the organisation were to be reduced by 10% or more?
- Is there a robust strategy in place to manage contingencies?

Assessing affordability also requires sound judgement of the organisation's business and requires that the:

- balance sheet is healthy and has been correctly organised and properly accounts for current assets, current liabilities, long-term liabilities and capital
- organisation is solvent and is not over-trading
- cash flows are sound, and
- appropriate contingencies have been made for risks and uncertainties.

Assess the impact on financial statements

The accounting impacts of the proposal on the organisation's operating statements and balance sheet should be assessed to ensure on-going financial viability and sustainability. Both the current position and the likely outcome should be fully recorded.

Outline any funding contingencies

When the level of funding required is uncertain and subject to contingent events, it is possible to establish rules and limits for accessing additional contingent funding.

Using a method such as quantitative risk analysis, funding recommendations can be set on the basis of a probability distribution of likely project costs. If project risks materialise, delegation limits can be set which determine the thresholds at which the organisation needs to seek approval from decision-makers, or provide additional evidence to support a request for additional funding. Annex Four contains an example of establishing contingency arrangements in the public sector.

Suggested evidence

In addition to presenting the results of the financial modelling for the preferred option, also provide:

- a description of the model and the costing methodology used
- all key assumptions in the model including how these assumptions were derived and agreed (for example, discount rates, inflation, taxation, depreciation, cost savings)
- a description of the proposed funding arrangements
- contingencies for risks and uncertainties, including scenario testing on key assumptions (where required)
- capital and operating impacts on the organisation's finances, and
- fiscal impacts on the organisation(s) baseline(s).

Management Case – Planning for Successful Delivery

Purpose of this part of the management case

This part of the management case is concerned with putting in place the arrangements required to ensure successful delivery of the preferred option (the “project”) and to manage project benefits and risks. Many of the high-level delivery issues should have been already initially highlighted to decision-makers and stakeholders as part of the previous Indicative Business Case.

Project planning should already be well advanced. The Senior Responsible Officer will have been appointed and the project initiated when the need for the investment was first identified, prior to the development of the Strategic Assessment. Initial analysis of risks and benefits associated with the preferred option has been undertaken in previous sections.

Action 20: Project Management Planning

Purpose

The purpose of this action is to develop the project management strategy, framework and plans to ensure successful delivery of the investment.

What’s expected?

Project management methodology

A robust project management methodology to guide the project through structured and visible processes to achieve the investment objectives. While this guidance is intended to be consistent with PRINCE2 (Projects IN Controlled Environment) project and MSP (Managing Successful Programmes) methodologies, this guidance is not intended to preclude the use of alternative management tools where these are recognised as good practice.

Project management and governance

Key project arrangements which includes:

- the governance structure and roles
- the project management structure including key roles and responsibilities
- project reporting and controls
- assurance

Project planning

A project plan which includes:

- the key deliverables required and the activities required to deliver them
- the critical path, key milestones and decision gates
- contingency plans for the non delivery of services as planned

Suggested evidence

Demonstration that the project management methodology is proven and suitable for this project. A project governance diagram which illustrates the key governance bodies together with their role and membership. Outline of the project structure and plan including the points at which progress will be monitored, controlled and reviewed.

Action 21: Change Management Planning

Purpose

The purpose of this action is to define the change management strategy, framework and plans required for the successful delivery of the preferred option.

What's expected?

An assessment of the change impact on the organisation, its customers and other stakeholders.

Development of the change management approach and initial planning together with the next steps.

Suggested evidence

The impact of the project should be described together with the change management approach including how service delivery, human resources and staff representatives, have contributed or been involved to date.

Action 22: Benefits Management Planning

Purpose

The purpose of this action is to plan for realisation of the benefits that have been identified and assessed in the economic case.[9]

What's expected?

Benefits realisation plan

Development of a benefits realisation plan to establish the approach to realising each of the project's benefits including how to identify, map, monitor and review the realisation process.

Benefits profiles

A profile for each benefit to be managed which includes:

- the investment objectives supported
- current or baseline measures and the improvement required
- the business changes required

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[9] Refer to *Managing Benefits from Projects and Programmes: Guide for Practitioners, http://www.treasury.govt.nz/statesector/investmentmanagement/plan/benefits/guidance/managingbenefits-guidance.pdf*

- any interdependencies between this and other benefits (inside or outside the project)
- the owner of the benefit, and
- a description of the measurement information (key performance indicators).
- Benefits realisation plan

An initial benefits realisation plan to track the realisation of benefits.

The typical content of a benefits realisation plan includes:

- a schedule detailing when each benefit or group of benefits will be realised, including any interim targets and measures prior to full realisation
- appropriate milestones for when a benefits review could be carried out, during and after project execution
- dates when specific outcomes will be achieved that enable the benefits
- risks associated with realising the benefits
- dependencies to other programme documents and plans, and
- details of any handover or embedding activities to sustain the process of benefits realisation after the project is closed, including identification of benefit owners.[10]

Suggested evidence

Description of benefits management approach and attachment of the benefits realisation plan.

Methods and tools

Benefits maps are a useful tool to show how the benefits relate both to each other and the programme or project so that realisation between the benefits can be managed and tracked.

Action 23: Risk Management Planning

Purpose

The purpose of this action is to detail arrangements for the on-going management of risk.

What's expected?

The expectation is that organisations will already have good practice risk management processes in place that follow the joint Australian New Zealand Standard AS/NZS ISO 31000:2009 *Risk management - principles and guidelines*.[11]

[10] For further guidance and templates, refer to *Managing Benefits from Projects and Programmes: Guide for Practitioners,* *http://www.treasury.govt.nz/statesector/investmentmanagement/plan/benefits/guidance/managingbenefits-guidance.pdf*

[11] For further detail, refer to AS/NZS ISO 31000:2009 *Risk management – principles and guidelines* – available from the Standards NZ website at http://www.standards.co.nz/

Risk management strategy

A fit for purpose risk management strategy to ensure the effective management of risks which includes:

- identifying possible risks in advance and putting mechanisms in place to either accept or minimise the likelihood of them materialising with adverse effects
- having processes in place to monitor risks, and access to reliable, up to date information about risks
- the right balance of control to mitigate against the adverse consequences of the risks, if they should materialise
- decision-making processes supported by a framework of risk analysis and evaluation
- establishing processes for reporting key risks to the project steering committee and escalating risks in dangers of requiring further management, and
- creation of an issues log.

The risk management strategy adopted should be fit for purpose.

The arrangements for the management of risk should be outlined, together with the respective roles and responsibilities and reporting lines of the posts concerned. These should be made clear in relation to the overall project management arrangements.

Risk register

The plans for the management of associated risks should be encapsulated within the risk register, which lists all the identified risks and the results of their analysis and evaluation. Information on the status of the risk is also included. A sample risk register is attached as an annex to this guide.

Suggested evidence

Description of the risk management strategy.

Action 24: Post Project Evaluation Planning

What's required?

Planning for a post project evaluation that considers:

- Were the objectives of the project met? Were there any unexpected outcomes or issues?
- How well did the project meet key stakeholders needs?
- Achievement of critical success factors?
- Key organisational lessons learned post-implementation?

Suggested evidence

Outline management arrangements for ensuring that the post project evaluation will take place, noting that this is a key responsibility of the senior responsible owner.

The Chief Executive's Letter

A letter should be provided by the Chief Executive and be included as an annex to the Detailed Business Case[12]. This letter should:

- demonstrate that the Chief Executive has been actively involved in the development of the investment proposal through its various stages
- confirm acceptance of the strategic aims and investment objectives of the investment proposal, its functional content, size and services
- confirm that the financial costs of the proposal can be contained within the agreed and available budget and a willingness and ability to pay for the services at the specified price level
- state the margins of leeway beyond which support must be revalidated, and
- demonstrate that suitable contingency arrangements are in place to work with suppliers to address any current or unforeseen affordability pressures.

[12] The Detailed Business Case template is available at http://www.treasury.govt.nz/statesector/investmentmanagement/plan/bbc/guidance

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Annex One: The Thirty Four Actions

	Strategic Assessment	Programme Business Case	Project - Indicative Business Case (Single Stage Business Case)	Project - Detailed Business Case (Single Stage Business Case)	Implementation Business Case
Strategic Case	Action 1: The Case for change	Action 2: Strategic Context Action 3: Investment Objectives, Existing Arrangements and Business Needs Action 4: Potential Business Scope Action 5: Benefits, Risks, Constraints and Dependencies	Action 2: Strategic Context Action 3: Investment Objectives, Existing Arrangements and Business Needs Action 4: Potential Business Scope and Key Service Requirements Action 5: Benefits, Risks, Constraints and Dependencies		Action 27: Revisit the case for change
Economic Case			Action 6: Critical Success Factors Action 7: Long List Options and Initial Options Assessment Action 8: Recommended Preferred Way Forward	Action 9: Revisit the Indicative Business Case and Confirm the Short List Action 10: Economic Assessment of the Short-Listed Options Action 11: Non-monetary Benefits and Costs Action 12: Risk and Uncertainty Action 13: The Preferred Option	Action 28: Revisit Detailed Business Case options
Commercial Case				Action 14: The Procurement Strategy Action 15: Specify Requirements Action 16: Risk Allocation Action 17: Payment Mechanisms Action 18: Contractual and Other Issues	Action 27: Evaluation of best and final offers Action 28: The negotiated deal & contractual arrangements
Financial Case				Action 19: The Financial Costing Model	Action 29: Financial implications of the deal
Management Case				Action 20: Project Management Planning Action 21: Change Management Planning Action 22: Benefits Management Planning Action 23: Risk Management Planning Action 24: Post Project Evaluation Planning	Action 30: Finalise Project Management Arrangements Action 31: Finalise Change Arrangements Action 32: Finalise Benefits Arrangements Action 33: Finalise Risk Management Action 34: Finalise Post Project Evaluation Planning

Annex Two: Techniques to Quantify Risk and Uncertainty

Optimism bias

The simplest form of quantification of risk is by applying optimism bias contingencies to costs or timeframes to reflect the systematic tendency for project teams to be over-optimistic about key parameters. The adjustments can be based on past empirical experience of similar projects and should be reduced at different stages of the business case development as progressively better estimates are made[13]. While simple, the disadvantages are that it reflects downside risks only and is unlikely to effectively manage or mitigate risks.

Single-point probability analysis

An expected value can be calculated for each significant risk by multiplying the likelihood of the risk occurring (probability) by the size of the consequence. This risk premium is expressed in monetary terms and provides an estimate of the cost of accepting all the risk.

It is best used when both the likelihood and consequence of the risk event can be estimated reasonably well. The disadvantage is that it provides no information about the underlying variability in outcomes or consequences, particularly at the extremes when decision-makers may prefer not to accept the risk of the event occurring.

Quantitative risk analysis (QRA)

For any risk, a range of possible outcomes (and consequences) is more likely. An output probability distribution provides a more complete picture of the possible outcomes and recognises that some of these outcomes are more likely to occur than others.

Quantitative risk analysis (QRA) is a modelling technique that makes risks, and the financial impact of those risks, more explicit to decision-makers when considering the business case. This recognises that using single point estimates for comparing options can provide relatively limited information about the underlying trade-offs.

QRA of costs is mandatory as part of the development of a Detailed Business Case (DBC) for significant projects or programmes monitored by the Treasury. The Ministry of Business Innovation and Employments consultancy panel maintains a list of accredited quantitative risk analysis experts for use by Government agencies.

Quantitative risk analysis can provide a better understanding of the sources of risk to project outcomes and more accurate estimates of the likely costs or benefits. Generally a quantitative risk analysis approach is considered to be superior to an approach that solely relies on optimism bias or contingencies. Quantitative risk analysis should be used as the first-best basis and is required for high risk, large scale investment proposals.

Quantitative risk analysis conducts detailed sensitivity analysis and analysis of the likely effect of these scenarios on project outcomes. This involves assessing each probability and

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[13] Refer to the HM Treasury Green Book supplementary guide at https://www.gov.uk/government/publications/the-green-book-appraisal-and-evaluation-in-central-governent

consequence and modelling project outcomes based on simulations of each risk. The final probability distribution describes the range of outcomes and their relative likelihood.

The risk modelling process involves:

a. building the models

b. including distributions for uncertain inputs

c. simulating outcome distributions

d. generating outcome graphs and tables, and

e. reviewing and revision as necessary.

Impacts, other than financial, must also be considered and documented.

Monte Carlo analysis

Monte Carlo analysis is a specific risk modelling technique that uses statistical sampling and probability distributions to simulate the effects of uncertain variables on model outcomes. The approach provides a systematic assessment of the combined effects of multiple sources of risk in key variables and can also allow for known correlations between these variables. Using Monte Carlo can require expert advice to develop the model and interpret the results.

The Monte Carlo approach is more suited to proposals where there are several key variables with significant and/or correlated uncertainties, and when simpler sensitivity analysis approaches are unable to adequately describe the resulting variation in net benefits between competing options.

Annex Three: Approaches to Sensitivity Analysis

Sensitivity analysis should be undertaken using two approaches:

i scenario analysis, and

ii switching values.

Scenario analysis – testing "what if"

Scenarios are useful in considering how options may be affected by future uncertainty. Scenarios should be chosen to draw attention to the major uncertainties and assumptions on which the success of the proposal depends.

Are there any variables (such as exchange rates, salary costs, demand drivers, timing or assumptions) that materially influence the net benefits? These key variables should be identified using the risk and uncertainty process above.

The scenario analysis should then focus on asking "what if" questions and recalculating the expected Net Present Value for several scenarios. For example, what if one or more sensitive/key variables were changed by ±10%, or ±50%, or whatever is a realistic and possible variation. What if related Government policy altered or critical legislation is not passed? If these events occur, should the proposal proceed? Under what circumstances does the preferred option change? A common approach is to test three scenarios:

i pessimistic or conservative scenario

ii most probable or base scenario, and

iii optimistic scenario.

Switching values

This is a "what if" scenario test that highlights how much a given variable (eg an uncertain cost, benefit or key assumption) would have to change to alter the choice of the preferred option. Judgements may be necessary to model how the change would alter the choice of the preferred option.

Examples of variables that are likely to impact on the robustness of the choice of the preferred option may include growth of real wages, forecast revenues, demand, prices, and/or assumptions about the transfer of risk. An understanding of how costs fall into fixed, step, variable and semi-variable categories can also help in understanding the sensitivity of the costs of given options.

The table over the page is an example of an off-shore procurement of capital assets valued at $US23.9 million at an exchange rate of $NZ0.66 (based on option 3 in Table 2 above) and with different exchange rate and price discount scenarios.

Sensitivity Testing of Option 3	Conservative Scenario	Base Scenario	Optimistic Scenario
Exchange Rate ($NZ per US$)	$0.60	$0.66	$0.75
Negotiated purchase price discount	10%	15%	25%
Resultant Net Present Value (NPV)	**$29**	**$35**	**$40**

Various ‘what if’ scenarios can be constructed by varying the two factors, exchange rate and price discount. The resulting impacts on the overall options analysis and the robustness of the preferred option can then be considered.

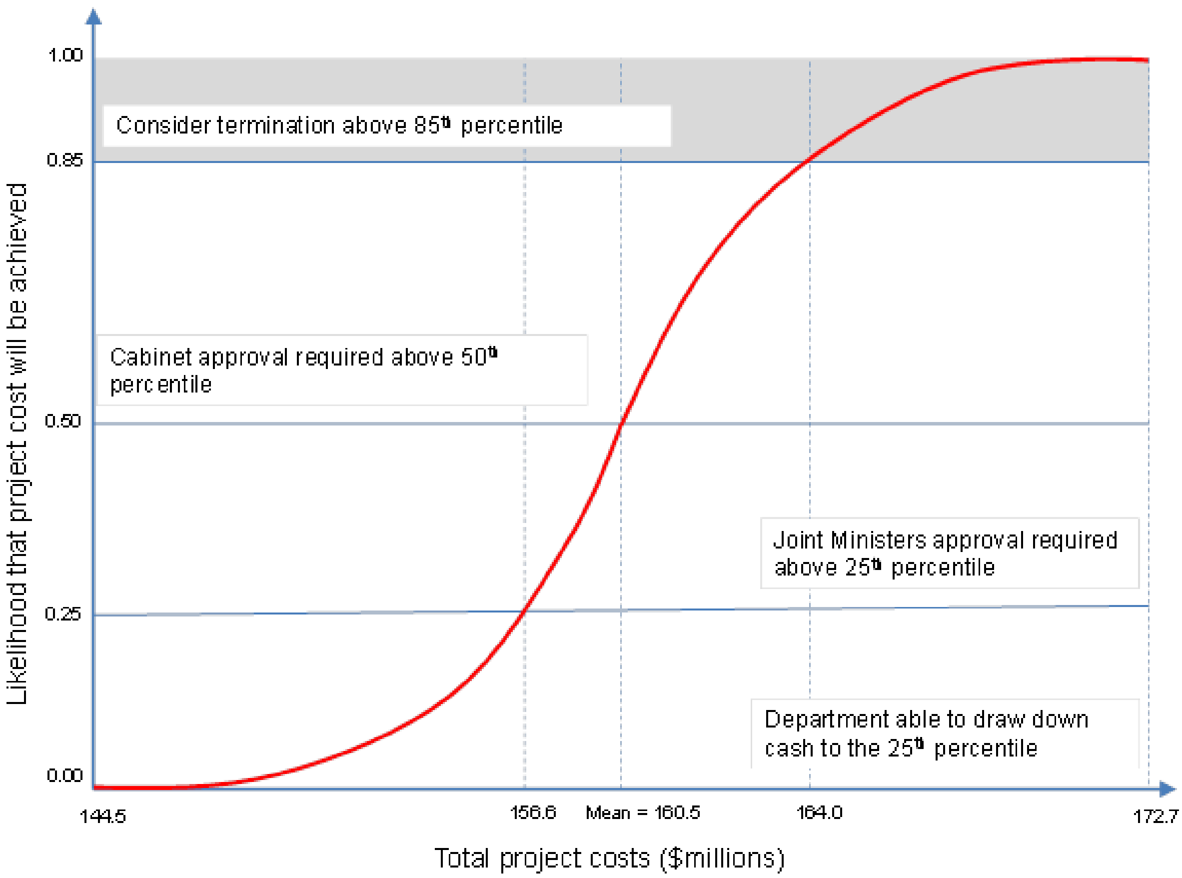
In the example above and keeping the purchase price discount constant at 15%, the analyst also determines that a worsening in the exchange rate is sufficient to change the choice of the preferred option from option 3 to option 4. The exchange rate of $0.60 is then a ‘switching value’. Switching value analysis is an important input to the decision on whether or not a proposal should proceed. These risks need to be clearly highlighted to decision-makers to enable them to accurately assess the degree of robustness of the preferred option.

Annex Four: Example of establishing funding contingencies

For the Public sector example below, initial approved funding is set at the 50th percentile but subject to requirements that specify that the project may only draw down funding to cover project costs up to the 25th percentile. Draw-downs between the 25th and 50th percentiles require the approval of Joint Ministers. Funding costs over the 50th percentile require further Cabinet approval and additional evidence. Project costs over 85% would signal consideration of early termination.

The threshold limits and rules should be set as part of the discussions with the monitoring agency, and included in the Cabinet Paper recommendations made as part of approving the Detailed Business Case.

An example of using estimated total nominal cumulative capital costs over a three year project development to inform draw-down arrangements for a Crown funded project. The drawdown limits and decision authorities can be altered to be fit for purpose for the nature of the proposal.



Annex Five: Considering PPP and Alternative Procurement Options

The New Zealand PPP Model

In the New Zealand context, a PPP is a long-term contract for the delivery of a service, where provision of the service requires the construction of a new asset, or enhancement of an existing asset, that is financed from external (private) sources on a non-recourse basis, and full legal ownership of the asset is retained by the Crown.

PPP procurement has been implemented in New Zealand for the primary purpose of improving the focus on, and delivery of, required service outcomes from major infrastructure assets. Whole of life services are purchased under a single long-term contract with payments to the contractor based on availability and performance of the asset. The combination of assets and services required to be delivered by the private sector are referred to in this document as the 'project'.

The PPP model seeks to improve outcomes by capturing best practice and innovation from the private sector. Lessons learnt from PPP projects can be implemented across a broader portfolio of public assets to significantly leverage the benefits of single PPP transactions. The competitive procurement process, focus on outcomes (with minimal input specifications and constraints), appropriate risk allocation and performance based payment mechanisms that put private sector capital at risk optimise the incentives and flexibility for private sector participants to deliver innovative and effective solutions.

PPP procurement is only used where it offers value for money over the life of the project, relative to conventional procurement methods. This means achieving better outcomes from a project than if it were procured using conventional methods, for the same, or lower, net present cost.

Further guidance documents and useful information can be found at www.treasury.govt.nz/ppp and the Treasury PPP Team can be contacted by email to ppp@treasury.govt.nz.

Cabinet Mandated Consideration of PPP Procurement

Procuring entities that are planning any 'significant investment' (including any arrangements with Local Government Authorities seeking Crown funding or support) must evaluate all procurement options, including PPP procurement.[14]

The Government Rules of Sourcing require agencies that are considering PPP procurement to:

- consult with the Treasury PPP Team early in the development of the project's business case
- follow relevant Treasury guidance and instructions
- involve the Treasury PPP Team in the economic and financial assessment and advice to Ministers

[14] In terms of financial or risk thresholds, 'significant' generally means investments that require Cabinet or Ministerial approval as per Cabinet Office Circular (15) 5, that is, high risk proposals, or proposals with whole of life costs (WOLC) in excess of $15 million, however funded. For further information, refer http://www.dpmc.govt.nz/cabinet/circulars/co15/5

- invite the Treasury PPP Team to participate in relevant project steering and working groups, and in the selection panels for all key PPP advisor appointments, and
- use the Treasury's Standard Form PPP Project Agreement as the basis for any contract and consult with the Treasury PPP Team over any proposed modifications.[15]

Considering PPP Procurement within the Detailed Business Case

Where PPP procurement is endorsed by Cabinet, the DBC will build on the analysis completed as part of the IBC[16] and Cabinet directive. Further qualitative analysis will be required as well as quantitative analysis in the form of compiling a Public Sector Comparator (PSC). Ideally, the scope of service provision to be included within the PPP will be confirmed at this time together with finalisation of the project's key outcomes and an indicative performance regime and risk allocation.

A number of actions required to complete a DBC require additional analysis where PPP procurement is a short list option. These include:

- Action 12: Risk and Uncertainty – a detailed understanding of project risks is required to ensure that the PSC is accurate and risk allocation is appropriate
- Action 14: The Procurement Strategy – consideration of the procurement process specific to PPP transactions is required together with a market sounding of the proposed solution
- Action 15: Specify Requirements – further consideration of the project scope and bundling options (particularly in relation to service provision) is required
- Action 16: Risk Allocation – a detailed risk allocation schedule will be required to be completed to ensure that those risks which will be transferred to the private sector partner are well understood and valued for the PSC
- Action 17: Payment Mechanism – the performance regime is central to the development of a PPP specific payment mechanism and this is discussed further below
- Action 18: Contractual and Other Issues – consideration is required in relation to the PPP project agreement and any project specific matters which may require amendment to the Standard Form PPP Project Agreement, and
- Action 19: The Financial Costing Model – the development of a PSC will be required to confirm that PPP procurement offers value for money over more conventional procurement approaches. This action is discussed further below.

While all of the above actions require a degree of additional analysis for PPP procurement, three (Actions 14, 17 and 19) specifically require additional components to consider PPP procurement.

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15 http://www.business.govt.nz/procurement/for-agencies/key-guidance-for-agencies/the-new-government-rules-of-sourcing

16 For further information on considering PPP procurement within the Indicative Business Case refer to http://www.treasury.govt.nz/statesector/investmentmanagement/plan/bbc/guidance/bbc-indbus-gd.pdf

Action 14a: A second market sounding

A second market sounding is required during the preparation of the DBC (often late in the process) and serves two key purposes:

- It provides the procuring entity a final opportunity to test its proposed solution with the market. This is important as private sector parties will not respond positively to a project which it considers is underdeveloped or likely to change, and

- It allows private sector parties to understand the objectives and outcomes sought by the procuring entity and form credible consortiums and teams to respond to a possible procurement process. It is important that procuring entities allow the market sufficient time prior to the release of an EOI to ensure complete and competitive responses.

Action 17a: Development of a performance regime

Additional analysis is required to consider the specific performance standards and penalties which may be applied in the PPP project agreement. This requires the procuring entity to determine how the asset and service will be funded (on either an availability or user charge model) as well as how payment will be linked to the specific performance of the service outcomes required.

The procuring entity will need to consider how the performance regime can incentivise the delivery of those outcomes through performance payments and abatements as well as penalties for incidents which are simply unacceptable to the procuring entity.

The procuring entity should consult with the Treasury PPP Team regarding the proposed performance regime.

Action 19a: Development of a public sector comparator

Additional quantitative, or value for money, analysis is required for PPP procurement. This analysis compares the cost of procuring a project as a PPP with a PSC that represents the cost if the procuring entity were to deliver the asset and services itself using conventional procurement. This assessment requires detailed consideration of costs associated with:

- the design and construction of the asset

- the maintenance and management of the asset throughout a prescribed period of operations

- the delivery of services from the asset (where these are to be included under a DBFMO model), and

- those risks relating to the asset and service delivery that are proposed to be transferred to the private sector under PPP procurement.

The PSC must then be compared with a Proxy Bid Model (PBM), which in addition to those costs included within the PSC also seeks to replicate those additional costs associated with PPP procurement (such as additional procurement costs and private sector costs of financing the project). The DBC must satisfy decision makers that there is sufficient scope for the private sector to introduce innovation and whole of life cost savings (through asset design, maintenance and risk transfer) to offset any difference between the PSC and PBM.

This analysis is important as PPP procurement will only be approved for a project where it offers value for money over the life of the project; that is, a PPP must deliver the outcomes sought from the project for the same or lower cost than the procuring entity could have itself (as established by the PSC). This is safeguarded through the requirement for Cabinet approval of the value for money case before a PPP project agreement may be signed for any PPP project.

Further guidance on the development of a PSC and quantitative value for money analysis has been published by the Treasury PPP Team (*Public Sector Comparator and Quantitative Assessment*).[17]

Project Characteristics and Suitability of PPP Procurement

PPP procurement is most likely to be appropriate for projects of large scale and long duration where:

- the nature of the asset required is specific and can only be applied to the purpose intended (such as a prison or hospital)
- the service is durable and it is unlikely that the service requirements will vary unpredictably over the life of the contract
- outcomes or outputs can be well-specified, enabling clear specification and monitoring of performance requirements and standards
- the project is sufficiently complex that innovative design and service approaches may be employed, and
- there is sufficient market appetite and depth to ensure a competitive procurement process.

Nature of the Required Asset

The nature and characteristics of the asset required to deliver the service outcomes of the project are an important driver in considering procurement options. Where the asset required is relatively generic and could have a range of applications, it is unlikely that there will be a strong imperative for the Crown to retain ownership of the asset. In such a case the best value for money option may be private provision such as through a lease arrangement.

Where the required asset is highly specific to the proposed use (such as a prison or hospital), it is more likely that public ownership will be favourable to private ownership. The limited application of such an asset to other uses will mean that a private owner will likely seek to recover the full cost of the asset over the duration of the lease which is unlikely to be value for money for the Crown.

Once the preferred ownership structure has been identified, those procurement options relevant to the ownership structure can be identified and considered. PPP procurement is only considered appropriate for assets for which long-term Crown ownership is preferable.

[17] http://www.treasury.govt.nz/statesector/ppp/guidance/public-sector-comparator

Outcome specification

As a general rule, if the required asset or service can be well specified, then it is likely that it can be measured and delivered by a third party under a contractual relationship.

Additionally, where the service can be clearly specified, clear performance specifications can be formulated to ensure higher levels of service outcomes can be contractualised and enforced. The PPP project agreement can include incentives to deliver stronger performance, resulting in greater efficiency and higher quality service outcomes.

Service outcomes which cannot be well specified, however, risk undermining the performance regime and, ultimately, the procuring entity's control over the asset and its performance.

Durability of service specification

The durability of the service specification is also a crucial issue for a public sector practitioner to assess as it will dictate the potential tenure of the contract. If a contract is easily specified and the nature of that service is unlikely to change significantly then it may suit a procurement model with a long contract term such as PPP procurement. A shorter duration may be preferred where the required scope of an outsourced service is unpredictable in order to mitigate a risk premium being charged by the service provider due to uncertainty.

Project complexity

Complexity (both in terms of asset and service provision) is also an important consideration in determining the suitability of PPP procurement for a specific project. Greater opportunity exists for a private sector partner to introduce an innovative solution where the project has a higher level of complexity. Innovation may include approaches that provide improved service outcomes or reduce the overall cost of the project.

Conversely, care should be taken to ensure that a project's complexity and a private sector partner's response do not undermine the value of the overall project. This might arise through the creation of difficult or costly interface issues with other services provided by the procuring entity or increased contract management and enforcement costs.

Project scale and cost

The size of the project (both in terms of asset and service provision) is an important criterion when considering procurement options and the suitability of PPP procurement.

The larger a project is, the greater ability it will likely have to absorb the transaction costs associated with PPP procurement and attract market interest. A small project or service contract may not be able to sustain those transaction costs associated with the required market development, procurement and monitoring inherent in PPP procurement, reducing the value for money proposition.

The procuring entity's contract management competency

Effective management of outsourced service contracts is critical regardless of the form of procurement. However, due to the level of complexity inherent within the performance regime, PPP procurement requires a higher level of active contract management than other forms of procurement. Effective contract management is most likely to occur where service performance can be readily measured and the procuring entity has the requisite contract management resource and expertise.

Where the adoption of PPP procurement for a specific project requires a procuring entity to establish a contract management function, consideration should be given to the likelihood of further PPP projects or other opportunities to utilise this capability. If such opportunities are not apparent, the additional cost of establishing and maintaining this contract management functionality may diminish the value for money of procuring the project as a PPP.

A procuring entity considering PPP procurement should consult the Treasury PPP Team in developing its contract management plan. The Treasury PPP Team are able to provide advice on best practice PPP contract management as well as the Treasury's ongoing contract monitoring framework.

Competitive tension

The nature of the asset and service outcomes required will determine whether there are sufficient suppliers in the New Zealand market to ensure a competitive process to deliver value for money. Factors both internal and external to the project may have an impact on the level of competition available and the procuring entity must ensure that the project and potential procurement methods are robustly tested with interested parties.

The number and nature of interested parties will play an important role in delivering value for money and innovation within the project. Early engagement with the market is required to ensure that interested parties have sufficient opportunity to consider the opportunity and form consortia. This is particularly important where the project is likely to attract interest from new or international parties.

Engaging with the Treasury PPP Team

The Government has established a PPP Centre of Expertise within the Treasury which is responsible for:

- developing PPP policy
- advising agencies in respect of PPP procurement
- developing and maintaining the PPP market in New Zealand, and
- the PPP procurement model and Standard Form Project Agreement.

The Treasury PPP team understands that the requirement to consider a new procurement model can be daunting and encourages early engagement to discuss the PPP model and its suitability for a specific project. Ownership of, and responsibility for, all PPP projects remains with the respective procuring entity and seeking early engagement with the Treasury PPP team on procurement options will provide opportunity to understand how PPP procurement may suit project and agency requirements.

Early engagement allows scope for full consideration of alternative procurement options on a best-for-project basis. It also provides maximum opportunity to leverage lessons learnt from other projects and international best practice in the development of procurement options for a project.

The Treasury PPP team is able to provide agencies valuable assistance through:

- providing an understanding of the New Zealand PPP model and policy
- the development of the economic, financial and commercial cases component of a project's business case (in particular, consideration of procurement options, market sounding, risk analysis and the development of a PSC)
- experience in planning the procurement process and engagement with potential private sector partners
- established relationships with market participants including advisors, investors, contractors and service providers
- providing insight from lessons learnt and experience from PPP projects in other sectors, and
- representation within the project's steering group and project team to provide support and direction throughout the procurement and negotiation phases.

Departments or agencies considering a significant investment may discuss the potential for applying PPP procurement with their Treasury vote manager or contact the Treasury PPP team directly.