

Capital Asset Management Better Business Cases for Capital Proposals 2011

Agenda

- Welcome and ground rules
- Context: Capital Asset Management
- Overview (why, when, what is expected, who is involved)
- Lessons from the UK
- The 5 Case Model
- The process
- Where to get support

Break - senior managers leave

- Experts by business case deliverable
- Practitioners with real-life business case examples (depending on agency's requirements)
- Pitfalls: Economic Appraisal – Common Errors (from UK)

Context: Capital Asset Management

- The Capital Asset Management (CAM) Framework was endorsed by Cabinet and implemented from 2008;
- Initial CAM focus on “Better Capital Planning” with agencies providing ten year Capital Intentions Reports to inform “resource prioritisation of capital proposals” during the Governments Budget process (early visibility);
- Better Business Cases for capital proposals introduced mid 2010;
- BBC based on international good practice from the UK (5 Case Model, process and project assurance) and Victoria (Investment Logic Mapping for early problem definition and benefit identification), all combined and adapted for New Zealand;
- Standards of practice system to go live early 2012;
- Review CAM with stakeholder groups in February for release of changes in July.

Overview: Why better business cases?

The government wants to improve the quality of business cases to inform their decisions on capital proposals. The BBC process assists this through:

- Clear rules and expectations
- Clear processes
- Scalable standard
- Clear guidance, training and ongoing support

Key stakeholders include:

- Decision makers/Ministers
- Agency management
- Agency business case developers
- Monitoring agencies, and
- Private sector vendors



Overview: When does it apply?

All capital proposals from Departments, Crown Agents and other Crown Entities, which meet one or more of the following criteria:

- Access to new Crown funding
- Public Private Partnerships (excluding other Crown Entities)
- \$25 million whole-of-life cost (Departments only)
- “High risk” per Gateway Risk Profile Assessment (Departments and Crown Agents only)
- Asset disposals with significant policy decisions



Overview: What is expected?

If a proposal requires Cabinet approval:

- Engage them early in the decision-making process
- Follow the two-stage process
 - Stage 1: Based on the Indicative Business Case
 - Stage 2: Based on Detailed Business Case

**The process is about
thinking not writing**

The development of a business case includes:

- Demonstrating the thinking has been done
- Presentation to monitoring agencies
- Presentation to decision makers.

Expectation that the process will be used even where approval is not required

Overview: Expectations are scalable!

The development process is scalable to ensure that the level of effort is fit for purpose and matches the scale, risk profile and type of decision required.

| | | | |
|---|---|---|-------|
| Risk (SSC Gateway Risk Profile Assessment tool) HIGH LOW | High Risk Small Scale <ul style="list-style-type: none"> ILM facilitator Strategic assessment agreed by Joint Ministers Two stage cabinet approval Moderate CBA/MCA in detailed business case Assurance: IQA and Gateway | High Risk Large Scale <ul style="list-style-type: none"> Independent ILM accredited facilitator Strategic assessment agreed by Joint Ministers Two stage cabinet approval Full CBA/MCA with QRA in detailed business case Assurance: IQA and Gateway | |
| | Low or Medium Risk Small Scale <ul style="list-style-type: none"> ILM facilitator Strategic assessment not required Single stage Cabinet approval Light CBA/MCA Assurance: No Gateway <p>Only if Crown funding is required</p> | Low or Medium Risk Large Scale <ul style="list-style-type: none"> ILM facilitator Strategic assessment agreed by Joint Ministers Two stage cabinet approval* Moderate CBA/MCA in detailed business case Assurance: No Gateway <p>* Cabinet may agree at stage 1 to conditionally delegate stage 2 approval to Joint or Responsible Ministers</p> | |
| | SMALL | \$25m | LARGE |
| | Scale (Whole of life costs - \$million) | | |

Overview: Who needs to be involved?

The Better Business Cases process is most successful when:

- Agencies engage with central and monitoring agencies in the early stages of each business case deliverable to ensure the business case will be fit for purpose. Agreement will be sought on:
 - Type of business case
 - Timing and nature of decision required
 - Scale and risk of the proposal
 - Scope of analysis required for each case-including reviewers criteria/evidence
 - Level of effort and cost for development and assurance
 - Scope of the engagement during the development of the business case
- The scoping document is used to secure early agreement (See Overview Guidance Booklet)

"This is about ensuring the right balance between flexibility and discipline."

Lessons from the UK

- Relevant background – BBC Programme

The introduction of a structured methodology to develop and present business cases (5 Case Model) has resulted in:

- **Improved VfM** (Value for Money)
 - Reduced cost (40%)
 - Improved efficiency and throughput
 - Improved outcomes
 - Better evidenced VfM
 - Realistic and achievable “do minimums”

Lessons from the UK continued

- **Key cultural changes**
 - Common standard and language
 - Planning v approval
 - Business v project assurance
 - Business needs v benefits
 - Services v assets
 - Economics v financials
 - Earlier consideration of Commercials
- **The alternative!**

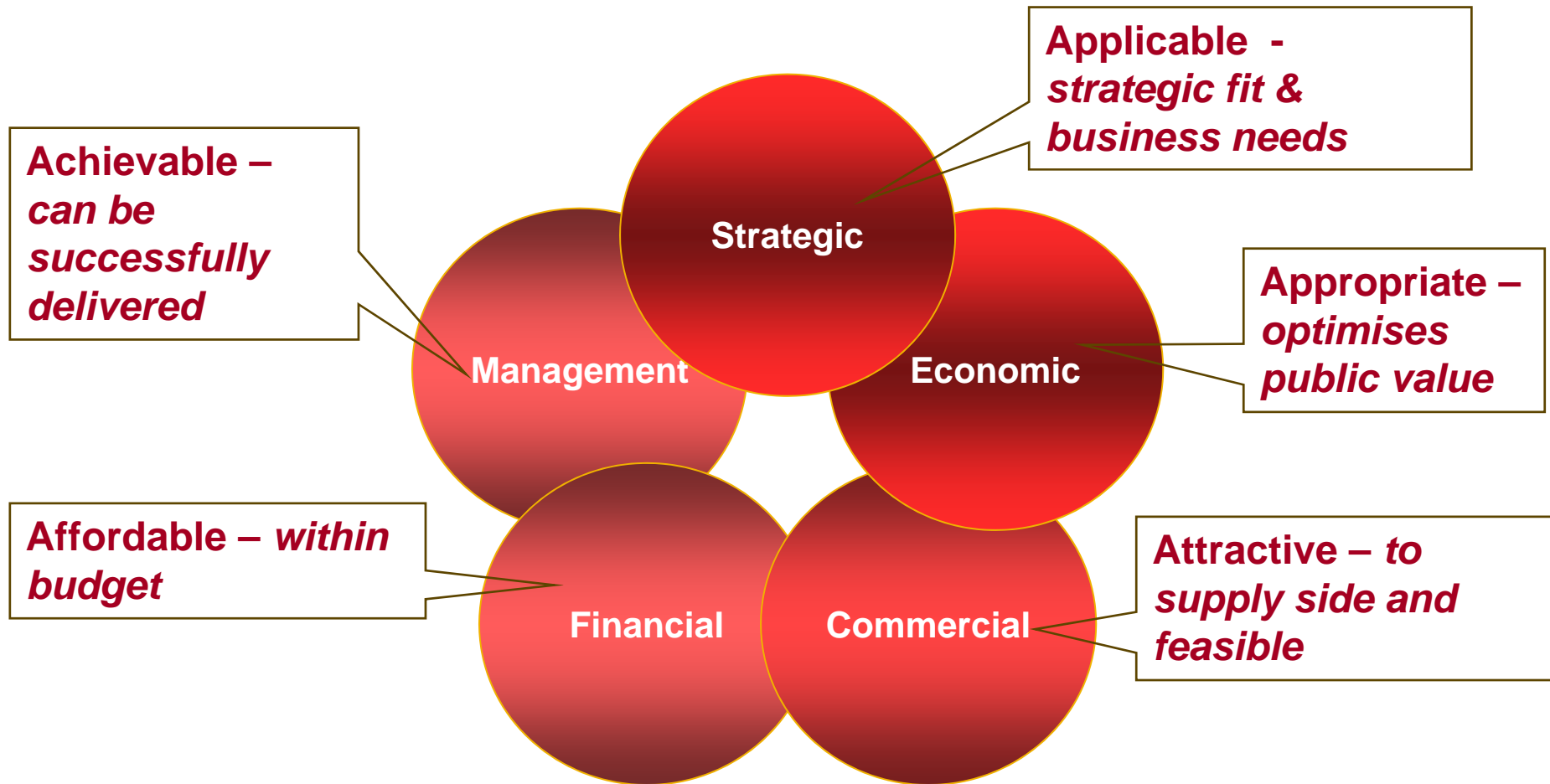
The 5 Case Model

Addresses 5 key questions

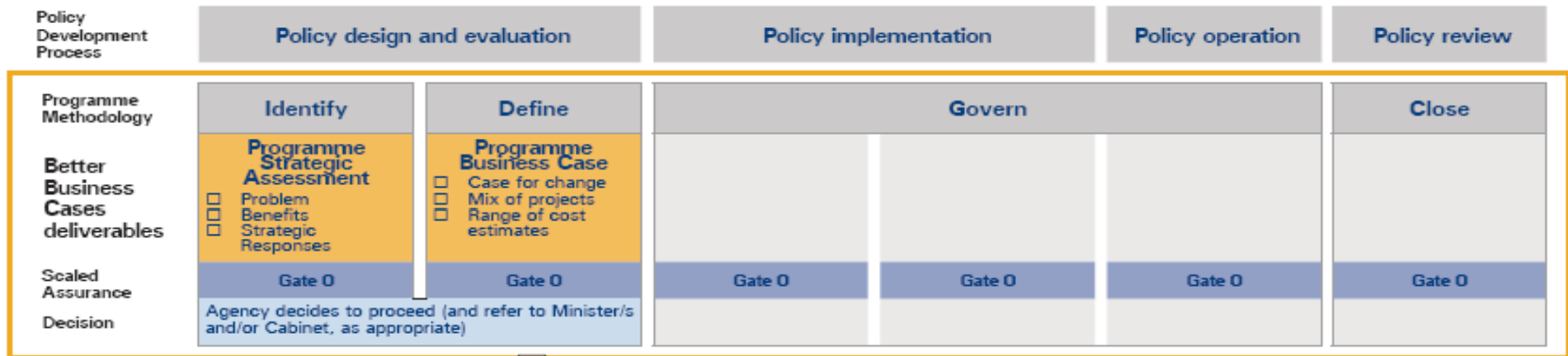
1. Is there a compelling case for change?
2. Does the selected option optimise public value?
3. Is the potential Deal achievable and attractive to the market place?
4. Is the spending proposal affordable?
5. How will the proposal be delivered successfully?

The 5 Case Model

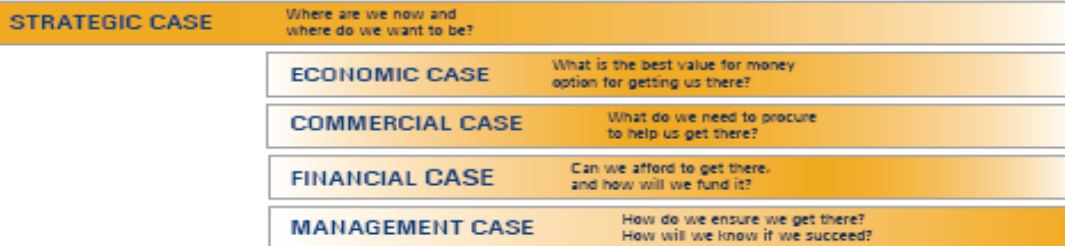
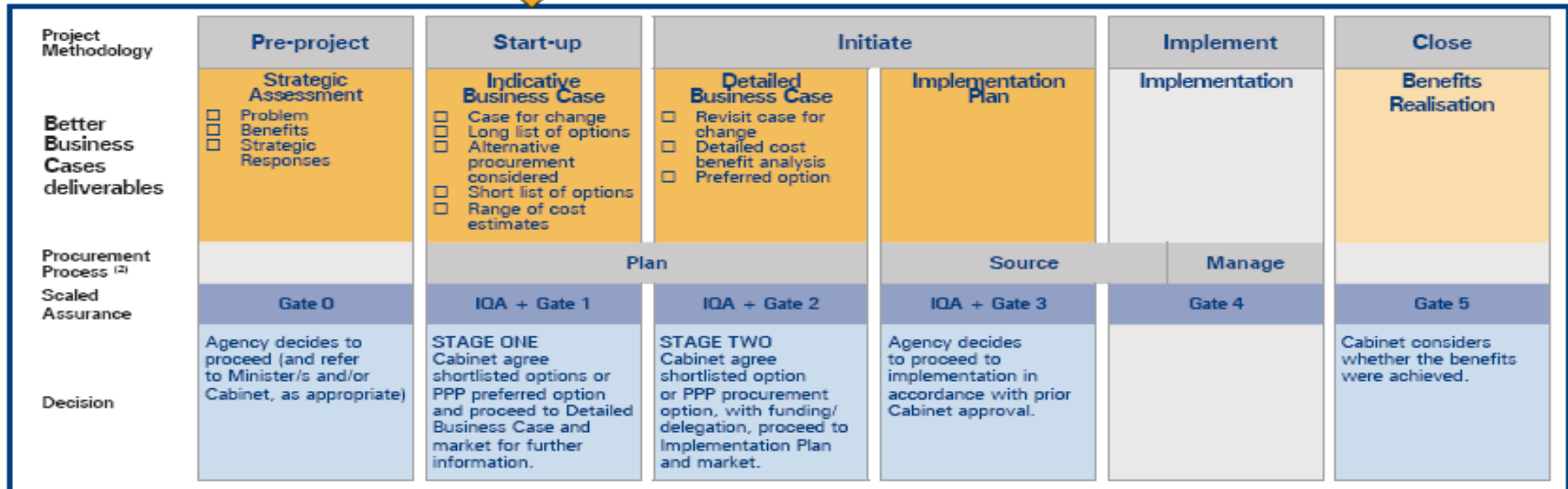
The 5 key elements of best practice business cases



The Process: starting with a capital plan



OR



Scale of emphasis of the five cases in relation to the deliverable

5 Case Model

(2) During the pre-project and start-up phases, prior to the procurement process, organisations are encouraged to consult with suppliers and industry bodies. Refer to the Overview Booklet for further guidance.

Where to get support

The National Infrastructure Unit (NIU):

1. Monitors and periodically updates the Better Business Cases guidance on the Infrastructure website and the Public Sector Intranet (PSI)
2. Reviews, develops and delivers support to agencies
3. Provide facilitation between agencies and their monitoring agencies (to secure early agreement using scoping document)

For any queries or for further information please contact:

betterbusinesscases@treasury.govt.nz

Where to get support

The National Infrastructure Unit (NIU) provides the following support:

- Quick Reference Guide
- On line module (on the website)
- Guidance booklets (on the website and psi)
- Links to relevant guidance (on the website and psi)
- Awareness seminars to senior managers
- Training to agency practitioners, including examples
- Workshops on how to apply the business case process
- Clinics to assist agencies as they develop business cases
- Communities of practice to exchange experiences with peers
- List of agency business case examples (on the psi)

Break

Better Business Cases for Capital Proposals

Expert: Strategic Assessment

Better Business Cases for Capital Proposals Toolkit: Strategic Assessment

Strategic Assessment

- What is it for?
- When is it needed?
- What is involved?
- Either at project or programme level



Refer to the BBC Toolkit: Strategic Assessment booklet available on:

<http://www.infrastructure.govt.nz/publications/betterbusinesscases/strategicassessment>



Strategic assessment

Strategic Case-Making the Case for Change

Action 1: Ascertain strategic fit

- Identify the core reason that underpins the service need by identifying :
 - the problem?
 - the best strategic response?
 - benefits that need to be delivered?
- Use Investment Logic Mapping process with ILM facilitator and the right stakeholders



Expert: Programme Business Case

Better Business Cases for Capital Proposals Toolkit: Programme Business Case

Programme Business Case

- What is it for?
- When is it needed?
- What are the actions?



Refer to the BBC Toolkit: Programme Business Case booklet available on:
<http://www.infrastructure.govt.nz/publications/betterbusinesscases/programmebusinesscase>



Programme Business Case

Strategic Case-Making 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



Programme Business Case

Economic Case-Exploring the Preferred Way Forward

- Determine the scale and likely costs of the programme
- Determine the mix of capital projects
- Include the consideration of non-asset options



Expert: Indicative Business Case

Better Business Cases for Capital Proposals Toolkit: Indicative Business Case

Indicative Business Case

- What is it for?
- When is it needed?
- What are the actions?



Refer to the BBC Toolkit: Indicative Business Case booklet available on:

<http://www.infrastructure.govt.nz/publications/betterbusinesscases/indicativebusinesscase>



Indicative business case

Strategic Case-Making the Case for Change

Action 2: Strategic context

- Describes the organisation and identifies the investment objectives
- Demonstrates alignment with government's priorities and goals



Indicative business case

Strategic Case-Making the Case for Change

Action 3: Investment objectives, existing arrangements and business needs

Investment objectives:

- Desired outcomes
- Clearly relate to the underlying policies, strategies and business plans
- SMART and outcome-focused

Existing arrangements:

- Snapshot of where the department or agency is now

Business needs:

- Difference between where the organisation wants to be and where it is
- Highlight problems, difficulties and inadequacies and future changes in the demand for services



Indicative business case

Strategic Case-Making the Case for Change

Action 4: Key service requirements potential business scope

- Affected business areas, functionality and organisation
- Set out the boundaries or limitations
- Highlight the required services
- Forms the basis of the 'statement of needs' or 'statement of service requirements'



Indicative business case

Strategic Case-Making the Case for Change

Action 5: Benefits, risks, constraints and dependencies

- Basis for option selection and evaluation
- Benefits:
 - Direct/indirect, monetary/non-monetary and quantitative/qualitative
 - Measure against relevant benefits criteria
- Risks :
 - Identify sources, impacts and potential consequences
 - Emphasis on 20% of risks which will account for 80% of the total risk
- Constraints
- Dependencies



Indicative business case

Economic Case-Exploring the Preferred Way Forward

Action 6: Critical success factors

- Attributes essential to successful delivery of the proposal
- Crucial and set at a level which does not exclude important options
- Assess each option against these factors, the investment objectives and the benefits criteria



Indicative business case

Economic Case-Exploring the Preferred Way Forward

Action 7: Long-list options and initial options assessment

- Consider all realistic options for meeting the need
- Examine the advantages/disadvantages
- Use five categories

| Dimension | Details |
|----------------------------------|--|
| <i>Scale, scope and location</i> | What levels of coverage are possible? |
| <i>Service solution</i> | How can services be provided? |
| <i>Service delivery</i> | Who can deliver the services? |
| <i>Timing and staging</i> | When can services be delivered? |
| <i>Procurement</i> | How can it be funded? |



Indicative business case

Commercial, Financial and Management Cases (Outline)

Action 8: Recommended preferred way forward, if conventional procurement

- At least three short-listed options, including a base case option
- Provide range of indicative cost estimates for each short-listed option
- Make allowance for optimism bias



Indicative business case

Commercial, Financial and Management Cases (Outline)

Action 8a to d: Recommended preferred way forward, if alternative procurement is part of the short-listed options

Action 8a: Joint Ministers approve to proceed with more detailed economic assessment of the short-listed options

Action 8b: Undertake detailed economic analysis

Action 8c: Approach the market

Action 8d: Recommend preferred option with other procurement options for further assessment in DBC



Expert: Detailed Business Case

Better Business Cases for Capital Proposals Toolkit: Detailed Business Case

Detailed Business Case

- What is it for?
- When is it needed?
- What are the actions?



Refer to the BBC Toolkit: Detailed Business Case booklet available on:

<http://www.infrastructure.govt.nz/publications/betterbusinesscases/detail-edbusinesscase>



Detailed business case

Strategic Case (Revisit)

Action 9: Revisit the indicative business case

- Strategic case
 - Note changes made to underlying assumptions
- Economic case
 - Review the long-list and preferred way forward
 - Consider impact of changes to the assumptions



Detailed business case

Economic case

Action 10: Economic assessment of the short-listed options or preferred alternative procurement option

- Identify and quantify costs and benefits
- Apply discounting
- Rank using cost-benefit analysis with national perspective
- Tailor analysis to the size, impacts and risks of the proposal
- Consider supplementing with another methodology, e.g. cost-effectiveness analysis or multi-criteria analysis

Action 11: Intangible benefits and costs

- If significant they should be highlighted and explained
- Can be quantitative, qualitative, descriptive or a combination



Detailed business case

Economic case

Action 12: Risk and uncertainty

- Consider optimism bias – reduce by making adjustments to assumptions and variables
- Complete the risk assessment
- Complete the quantitative risk analysis



Detailed business case

Economic case

Action 13: Preferred option and undertake sensitivity analysis

- Rationale and evidence must be clear and defensible
- Option with the highest-risk-adjusted net present value
- Unless critical qualitative or non-quantifiable factors
- Fully involve stakeholders
- Use sensitivity analysis to tests the robustness of the CBA



Detailed business case

Economic case- the approach to options analysis

Actions 10 to 13

- Preferred tool is economic CBA
- Captures all benefits and costs regardless of to whom they accrue
- MCA only used to augment, not as an alternative, when a 'clean' CBA is not possible
- Incorporate MCA into the CBA process
- Includes the following steps based on CBA Primer on Treasury web site:



Options analysis example

| | Option 1: Do Nothing | Option 2: Do Minimum | Option 3: Preferred Minus | Option 4: Preferred | Option 5: Preferred Plus |
|--|----------------------------|----------------------------|---------------------------------|------------------------|--------------------------------|
| Appraisal 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 | 24.2 | 49.7 | 70.7 | 90.9 |
| Cost-Benefit Analysis (of [monetary costs and] benefits at the 2012 Public Sector Discount Rate 8.0%) | | | | | |
| Net Present Value of Benefits (\$m) | 2 | 25 | 75 | 115 | 126 |
| Net Present Costs (\$m) | 7 | 23 | 40 | 52 | 73 |
| Benefit Cost ratio | | 1.1:1 | 1.9:1 | 2.2:1 | 1.7:1 |
| Net Present Value (NPV, \$m) | 5 | 2 | 35 | 63 | 53 |
| Multi-Criteria Analysis [ranking of intangible costs and benefits (if any)] | | | | | |
| Criteria 1 | 1 | 3 | 3 | 5 | 1 |
| Criteria 2 | 5 | 2 | 3 | 2 | 4 |
| Criteria 3 | 3 | 2 | 5 | 1 | 3 |
| Preferred option | | | x | | |

Detailed business case

Commercial case – Preparing for the Potential Deal

Action 14: Procurement strategy

- Focus on how to procure the required services
- Act in compliance with the ‘Mandatory Rules for Procurement by Departments’
- Collaborative procurement offers flexibility, value for money and reduction in procurement costs



Detailed business case

Commercial case – Preparing for the Potential Deal

Action 15: Service requirements

- Scope and content of the potential deal
- Specify desired outcomes and outputs
- Specify quality attributes and performance measures
- Allow scope for service provider innovations

Action 16: Risk allocation

- Consider how risks are apportioned between the public and private sectors
- Allocate risk to the party best able to manage it
- Incentives for the private sector to supply timely, cost-effective and innovative solutions



Detailed business case

Commercial case – Preparing for the Potential Deal

Action 17: Payment mechanisms

- Reflect the balance between risk and return
- Relate payment to delivery of service outputs and performance of providers
- Incentivise providers in three stages
 1. Pre-delivery stage
 2. Operational stage
 3. Extension stage



Detailed business case

Commercial case – Preparing for the Potential Deal

Action 18: Contractual and other issues

- Contractual arrangements for the procurement
- Identify standard form of contract used
- Provide details of the accountancy treatment
- Identify any personnel implications to the investment proposal

Financial case – Ascertaining Affordability and Funding Requirements

Action 19: The financial costing model

- Consider Crown-related cash flows and accounting charges
- Specialist accounting capability required
- Detail the capital and revenue requirements for the preferred option
- Compare prices and quality levels of services offered by providers



Detailed business case

Management case – Planning for Successful Delivery

Action 20: Project management planning

Strategy

- Robust project management methodology required
- Based on best practice programme management principles and project methodologies

Framework

- Summarise how the project is organised including structure, reporting and governance
- Captured in a diagram and reproduced in the implementation plan

Plan

- Up-to-date summary should be included
- Address deliverables, activities, resources, dependencies and reviews



Detailed business case

Management case – Planning for Successful Delivery

Action 21: Change management planning

- Strategy – assess the potential impact of proposed changes
- Plan – provided for significant change management programmes

Action 22: Benefits management planning

- Management arrangements to ensure that expected benefits are monitored and realised
- Strategy – arrangements for identification of benefits, their planning, modelling and tracking
- Framework – assigns responsibilities for realisation of benefits
- Benefits register – details significant benefits expected as part of the economic case



Detailed business case

Management case – Planning for Successful Delivery

Action 23: Risk management planning

- Risk mitigation can lower the expected costs
- Strategies:
 - Identify risk and put response mechanisms in place
 - Create processes to monitor and report risks
 - Create an issues log
- Risk management:
 - Establish a risk management framework
 - Senior management support, ownership and leadership
 - Communication of risk management policies
 - Embed risk management into business processes



Detailed business case

Management case – Planning for Successful Delivery

Action 24: Post-project evaluation planning

- Strategy:
 - Improves project evaluation
 - Determines whether project has delivered improvements and benefits
 - Outlines the strategy for both aspects of post-project evaluation
- Framework – management arrangements to ensure that the evaluation takes place
- Plan – timing for post-project evaluation arrangements



Expert: Implementation Plan

Better Business Cases for Capital Proposals Toolkit: Implementation Plan

Implementation plan

- What is it for?
- When is it needed?
- What are the actions?



Refer to the BBC Toolkit: Implementation Plan booklet available on:

<http://www.infrastructure.govt.nz/publications/betterbusinesscases/implementationplan>

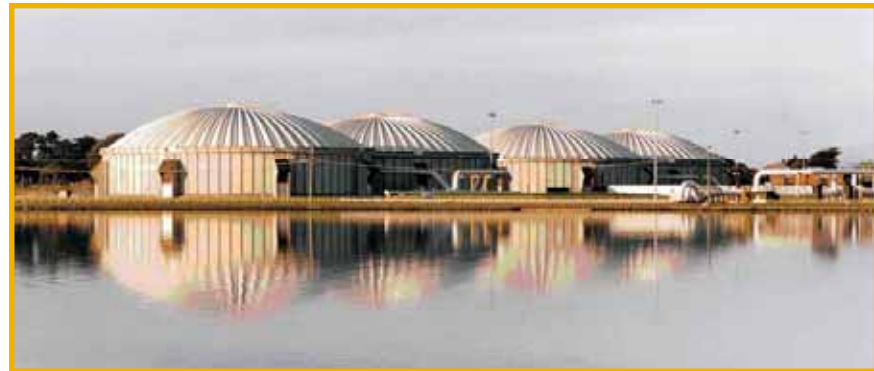


Implementation Plan

Strategic and Economic Case (Revisit)

Action 25: Revisit the case for change

- Revisit the strategic case – some aspects may have altered
- If not, note in the implementation plan
- If changes have occurred, identify:
 - strategic context
 - agreed investment objectives
 - business needs
 - earlier scope and service requirements
 - benefits, costs, risks, dependencies and constraints
- If changes are major, effects may require following-up throughout the entire case



Implementation Plan

Strategic and Economic Case (Revisit)

Action 26: Revisit the detailed business case options

- Demonstrate that conclusions of the economic assessment remain valid
- Update business case for any changes
- May impact on ranking and selection of options
- If alternative option is recommended, demonstrate that it offers better value for money

Commercial case – Preparing for the Potential Deal

Action 27: Evaluation of best and final offers

- Include an outline of the assessment of service provider proposals
- Explain any changes
- Record the basis on which the providers were selected and discarded



Implementation Plan

Commercial case – Preparing for the Potential Deal

Action 28: The negotiated deal and contractual arrangements

- Overview of preferred service provider deal
- Explain the:
 - service streams and outputs
 - implementation timescales
 - allocation of risk between the organisation and preferred provider
 - underpinning method of payment
 - type of contract used and the key contractual issues
 - accountancy treatment of the negotiated deal
 - personnel implications



Implementation Plan

Financial case – Ascertaining Affordability and Funding Requirements

Action 29: Financial implications of the deal

- Explains the financial implications to the organisation of the negotiated deal
- Layout follows the standard headings for the financial case
- Explain:
 - how the charges have been modelled
 - capital and revenue implications
 - net effect on user charges
 - impacts on financial statement
 - overall affordability and funding arrangements



Implementation Plan

Management case – Planning for Successful Delivery

Action 30: Finalise project management arrangements

- Revisit and update the project management arrangements
- Support of the design, build and implementation stages
- Latest version of the project plan should be attached

Action 31: Finalise change arrangements

- Revisit and update the change management arrangements and strategy
- Latest version of the change management plan should be attached
- Signed off by stakeholders for the services and indicate customer

Action 32: Finalise benefit management

- Revisit and update the benefits realisation arrangements
- Strategy for realisation of benefits should be revisited and re-affirmed



Implementation Plan

Management case – Planning for Successful Delivery

Action 33: Finalise risk management

- Revisit and update the risk management arrangements
- Revisit the strategy for the management of risks

Action 34: Finalise contract arrangements

- Outline the arrangements in place to manage contract change
- Consider the strategy for managing future contractual change
- Arrangements should be noted in the implementation plan

Action 35: Finalise post-project evaluation arrangements

- Revisit and update the post-project evaluation arrangements
- Record arrangements for future SSC Gateway Reviews at reviews 3, 4 and 5
- Record the arrangements for post-project evaluation



Practitioners

Economic Appraisal – Common Errors

By Joe Flanagan, UK author of the 5 Case Model

Common pitfalls to look out for

- Not doing an appraisal or creating a proper business case at the outset as an integral part developing the proposal
- Not considering sufficient options in long list
- Bad short listing, of options
- Failure to consider a do nothing option where this is possible
- Failure to consider a do minimum option (mandatory)
- Failing to include all costs and benefits to society, - just a public sector perspective is wrong, it is incomplete.

Common pitfalls to look out for - continued

- Double counting costs or benefits (e.g. including costs both in the base case and as a cost saving)
- Excluding the cost of using existing assets
- Including transfer costs* which should be excluded (* see notes)
- Lack of realism or over-optimism about costs, benefits and timings
- Failure to carry out sensitivity analysis.
- Evaluation proposals absent, no provision for useful feedback

Common pitfalls to look out for - continued

- Wrong life span of appraisal – whole life is needed
- A minimum of 10 years for services (0 to 9)
- Failure to include clear reference to sources and assumptions
- Wrongly including employment which is displaced and not new
- Failure to consider distributional implications
- Spurious justification of a non-standard discount rate

Wrap up

Any final questions or comments?