Ministry of Defence

JSP 507
Investment Appraisal and Evaluation

Part 1: Directive

Foreword

Sound appraisal and evaluation is the key to providing clear and transparent support for Evidence-Based Decision Making. Appraisal is the means by which the Department's policy objective of achieving Value for Money is demonstrated. Evaluation of projects, programmes and policies post-implementation is important to ensure good practice is perpetuated and lessons are learned.

I am pleased to present this updated guide, prepared by the Appraisal and Evaluation team within Defence Economics. JSP 507 promulgates the policy requirements and comprehensive practical guidance for undertaking appraisal and evaluation, and supplements the HM Treasury Green Book – Appraisal and Evaluation in Central Government. Whilst in the main intended for practitioners, this guide will also help non-practitioners to further their understanding of these tools for decision making.

I commend it to you and your staff.

DAVID WILLIAMS

DG Finance

Preface

How to use this JSP

1. JSP 507 is intended as a practical handbook on the application of appraisal and evaluation in the MOD. It is designed to be used by staff responsible for producing appraisals, and planning and carrying out project evaluations. It is also for those overseeing, scrutinising, and reviewing appraisals and evaluation plans. The JSP contains advice on the processes involved and the techniques to apply when preparing appraisals and evaluations.

2. The JSP is structured in two parts:

   a. Part 1 - Directive, which provides direction that must be followed, in accordance with Statute, or Policy mandated by Defence or on Defence by Central Governement.
   b. Part 2 Guidance, which provides the guidance that will assist the user to comply with the Directive.

Training

3. No guide or manual can give all the answers. Training in investment appraisals is provided by the Defence Academy who regularly run a two-day training course called ‘Investment Appraisal Skills’ (E043). All staff tasked with undertaking an IA for the first time should attend this or a similar course. Some TLBs operate their own IA training courses.

4. The Financial Skills Certificate (FSC) includes elements covering Investment Appraisal and Evaluation. Ideally, all IAs should be undertaken or reviewed by an individual with Intermediate Level FSC certificate in Investment Appraisal.

Further Advice and Feedback- Contacts

5. The owner of this JSP is Def Strat-Econ-AppEv-Hd. For further information on any aspect of this guide, or questions not answered within the subsequent sections, or to provide feedback on the content, contact any of the following members of the Appraisal and Evaluation team within Defence Economics:

Job Title/E-mail	Project focus	Phone
Def Strat-Econ-AppEv-Hd	PPP / PFI	020 7218 4538
Def Strat-Econ-AppEv-DepHd	Land / Personnel	020 7218 6027
Def Strat-Econ-AppEv-1	Sea / CIS / Nuclear	020 7218 2653
Def Strat-Econ-AppEv-2	Estates / Business Change	020 7218 6404
Def Strat-Econ-AppEv-3 (AE*)	Sea / CIS / Nuclear	020 7217 8949
Def Strat-Econ-AppEv-4 (AE*)	Air / Centre	020 7218 6010
Def Strat-Econ-AppEv-5	Air / Centre	020 7218 7496

(* AE denotes Desk Officer is an Assistant Economist)

TLB Contact Points

6. Each TLB has a focal point to support the appraisal and evaluation process, to produce appraisals when appropriate, and:

a. Provide the Senior Finance Officer (SFO), with an assurance that effective appraisal and evaluation processes are in place within their management area and staff adequately trained;
b. Provide advice and guidance to others within their management area preparing appraisals and evaluations;
c. Review business cases, appraisals, and evaluations undertaken within their management area to ensure compliance with TLB and departmental policy. This will include, as a matter of course, a review of business cases, appraisals, and evaluations that are to be submitted to a higher authority; and
d. Maintain details (and copies) of business cases, appraisals, and evaluations undertaken within their management area and a record of when evaluations are due.

TLB Appraisal and Evaluation Focal Points – as of December 2013			
TLB		**E-mail**	**Phone**
Air Cmd		Air-DResFPP-AAT SO1 MA	95221 7262
Head Office		HOCS Fin-AHGovernance&Research	9621 70440
		HOCS Fin-Governance	9621 82753
JFC		JFC-Fin-Scrutiny-Mgr	9360 55844
DE+S		DES CAAS-AT-DepHd	07880 785046
		DES CAAS-AT-SL2	9352 34372
DIO		DIO Fin-TLB DH	94421 3807
		DIO Fin-SAM AH	94421 3646
Navy		Navy Fin-Civpay Budman Decspt	93832 5233
Army		Army Res-Inv-Plans-Asst-Hd	96770 1338

7. Further advice should be sought in the first instance from your appraisal and evaluation focal point, and TLB guidance documentation. If they cannot help, they will refer the query to Defence Economics.

Contents

1 The Principles of Appraisal and Evaluation

This chapter explains what appraisal and evaluation are, and what they are for. It explains why appraisals and evaluations need to be objective and well planned, and that special care and consultation with Defence Economics is needed for cases going to Ministers.

An investment appraisal should be undertaken whenever a decision has to be reached which would involve the commitment of resources, or which would result in measurable benefits. Appraisal enables decisions to be made with a clear understanding of the costs and benefits of different choices.

The depth of appraisal should be commensurate with the scale, complexity, and sensitivity of the project, programme, or policy being appraised. An appraisal that covers all the steps in this guide is required when the capital investment exceeds £1M, or where total resource consumption over the planning period exceeds £10M. Some form of appraisal should be carried out on all expenditure proposals.

All projects, programmes, and policies requiring an investment appraisal should also be subject to subsequent evaluation. Plans for this should accompany the investment appraisal.

What is Appraisal?

1. Appraisal or Investment Appraisal (IA) is so called because its techniques have been developed mainly in the context of investment decisions. However, appraisal is equally applicable to decisions where no investment is involved.

2. Appraisal is a systematic process which entails being clear about the requirement, thinking about alternative ways of meeting the requirement, and estimating and presenting the costs and benefits of each potentially worthwhile option. It enables decisions about the use of resources or the generation of benefits to be taken with a better knowledge of their implications.

Why Appraisal Matters

3. In large measure public administration is about choices. Ultimately choices are made by Ministers or within a framework set by them. Ministers need the means to take informed decisions however, and it is government policy that investment appraisal techniques should be applied to major decisions involving the commitment of public funds. Government Accounting says:

> *"Investment appraisal (or more generally option appraisal) is an important part of good financial management, and it should always be applied to major capital developments."*

4. PUS, as Principal Accounting Officer, is answerable to Parliament, through the Secretary of State for Defence, for the efficient and effective use of MOD resources, and appears before the Public Accounts Committee to answer for the use of MOD resources. If decisions can be shown to be based on sound and thorough appraisals, and are properly evaluated, then the position of the Accounting Officer is protected.

The Purpose of Appraisal

5. An investment appraisal serves three main purposes.

a. Its prime function is to give the responsible manager the information he or she needs to make a sound decision. As such, appraisal is an essential part of the search for best value for money.
b. When a decision is outside the manager's delegated authority, then an appraisal will need to be presented as part of a submission for approval, and will form an important part of the case for gaining approval. A thorough appraisal that is well documented and presented will help to demonstrate that the project is soundly based and will smooth the process of gaining approval.
c. The appraisal also provides a record of what was expected to be achieved by the project and the factors on which the decision was based. It will be an important starting point for any later review or audit of the project, and in particular for project evaluation.

6. The aim is not to reduce decision taking to mere mechanics, but rather to place it on a rational and informed basis in which decisions are taken with a clear understanding of the costs and benefits of the available options.

Value for Money

7. In pursuing policy objectives, the objective of all public sector bodies is to achieve Value for Money (VfM) defined as optimising net social costs and benefits. The assessment of value is based upon the interests of society as a whole rather than to MOD or the public sector alone (see Part 2, Chapter 5, paragraph 27).

VfM can be defined as the optimal combination of:

a. Economy – i.e. Cost of Inputs (I/M : Inputs/Money)
b. Efficiency – i.e. Ratio of Output to Inputs (O/I : Outputs/Inputs
c. Effectiveness – i.e. Value of Outcomes from Outputs (V/O : Value/Outputs)

Hence VfM = I/M x O/I x V/O = V/M (Value / Money)

8. VfM can also be expressed as the optimal trade-off between time, cost and effectiveness. This does not necessarily mean choosing the lowest cost bid, nor highest performance regardless of the consequences. VfM is derived using the methodology set out in this Guide to provide a through life cost expressed in Net Present Value (NPV) terms considered alongside other significant factors that have not been possible to sensibly value (see Part 2, Chapter 5).

9. VfM is a relative concept which involves the comparison of potential and actual outcomes of alternative procurement options. VfM is only meaningful where options exist.

Where there is only one option then there is no real way of assessing VfM and in these circumstances the key is to achieve the most acceptable cost.

The Main Forms of Appraisal

10. As Government bodies are concerned with the well-being of the country; appraisals carried out by Government Departments will normally be prepared on the basis of the costs and benefits of using national resources. Here the cost is the 'opportunity cost', or loss of the alternative use to which those resources could be put (see Part 2, chapter 1, paragraph 35). Transfers of cash for which no goods or services are provided in return (called 'transfer payments') are not included (see Part 2, Chapter 1, paragraph 47). These appraisals are called '**Economic Appraisals**'.

11. In some cases economic appraisals will take the form of a **COST BENEFIT ANALYSIS (CBA)**, in which all of the costs and benefits of an activity are quantified and valued in monetary terms. The results of a CBA can be used not only to say which option is best, but also to indicate whether this option is worthwhile, i.e. does it provide a benefit exceeding its cost.

Example

The Health and Safety Executive produces CBAs of all proposals for new health and safety regulations. This involves estimating the extra cost employers will face in complying with the requirement, and the benefits in terms of reduced likelihood of deaths, injuries, illness and interruptions to work. These benefits are then given a monetary value based on the results of research into the costs of accidents and peoples' willingness to pay to reduce the risk of death and injury. The net present value of the difference between the costs and benefits can then be calculated.

12. As few activities within MOD produce benefits that can be valued in monetary terms, the use of full-blown CBA by MOD is extremely limited. One of the few areas where a CBA would be useful would be proposed health and safety or environmental measures that go beyond statutory requirements. Defence Economics should be consulted as to whether and how a CBA might be prepared in such cases.

13. Instead, most MOD appraisals take the form of a **COST EFFECTIVENESS ANALYSIS (CEA)**, which estimates the net present cost of alternative ways of achieving the same requirement. When there are differences in the extent to which the requirement is achieved, these will be noted, and as far as possible quantified, using measures which may be judgemental.

14. By including the status quo in the comparison of options, a CEA can establish whether <u>any alternative</u> option is worthwhile, as well as which option is best. It cannot though, on its own, establish whether the activity itself is worthwhile.

15. A highly formalised type of CEA is used for appraisal of new military equipment, and for other appraisals where the options to meet a requirement offer different levels of military or business effectiveness. This is the **COMBINED OPERATIONAL EFFECTIVENESS AND INVESTMENT APPRAISAL (COEIA)**. Here, the total through-life costs of the options to meet a particular requirement are estimated in the Investment

Appraisal. The individual parameters contributing to overall performance are identified, and each option assessed against each of these parameters in the Operational Effectiveness

Assessment. The two separate assessments are then combined to identify the overall cost effectiveness of each option. Guidance on COEIAs is provided in Part 2, chapter 2.

When an Investment Appraisal Should Be Undertaken

16. An investment appraisal should be undertaken whenever a decision has to be reached which would involve the commitment of resources; or which would result in measurable benefits. Examples include:

a. a new recruitment policy,
b. a works or accommodation project,
c. an equipment procurement,
d. a suggested redeployment,
e. estate rationalisation,
f. support for military exercises;
g. "spend to save" measures.

17. The depth of appraisal and the effort applied should be commensurate with the scale, complexity, and sensitivity of the project, programme, or policy.

Investment Appraisal Thresholds

Criteria	Threshold
Capital Investment	Exceeds £1M
Total resource consumption over Planning Review period	Exceeds £10M (excluding depreciation and cost of capital charges)
Novel or Contentious expenditure (see JSP 462)	All proposals regardless of value

18. An appraisal that covers all the steps described in this Guide is required where the capital investment, i.e. expenditure on new assets, or on refurbishing existing assets, exceeds £1M; or where total resource consumption, i.e. operating costs (excluding depreciation and cost of capital charge), is expected to exceed £10M over the planning period. This is an approximate guide only; the presumption should normally be in favour of a full appraisal for borderline cases, unless there are compelling reasons otherwise. <u>However, expenditure proposals below this level should still be subject to a business case that will need to address the same basic questions as those addressed in an investment appraisal.</u>

Example

Suppose it is proposed to use a building with a book value of £4M as accommodation for a group of relocated staff. New IT will be installed at a cost of £0.5M. Total resource costs of the organisation being relocated will be £2.5M p.a.

For IA threshold purposes, the cost of new capital is £0.5M, (new assets, inclusive of project management fees), and would not need a full IA. But total of costs in the planning period is £10M hence a full investment appraisal is required.

19. Senior Finance Officers (SFOs) have discretion to set lower limits for mandatory appraisal. Where SFOs decide to apply lower limits for mandatory appraisal, these should be followed. It remains the case that the basic principles of appraisal should be applied to all investment decisions, whatever threshold is set. There may well be cases below the threshold where an appraisal covering all the steps described in this Guide is appropriate because of the complexity or sensitivity of the project.

Who is Responsible for Undertaking Investment Appraisals?

20. Effective appraisal, evaluation and scrutiny are fundamental requirements of HM Treasury delegations and spending authority. Investment Appraisal is a key part of the management decision-making process, and not merely a finance or audit responsibility.

21. SFOs are responsible to DG Finance for the coverage and quality of investment appraisal throughout their area of responsibility. They should make arrangements for monitoring, and should make sure that they are made aware of any decision which runs counter to the conclusions of an investment appraisal, and any case where significant expenditure is to be committed without appraisal. They are required to cover investment appraisal in their annual reports to DG Finance on Corporate Governance in their area.

22. Within TLBs, appraisals should be carried out by the line management area responsible for implementing the project, programme or policy. Additionally, where projects span TLB boundaries, responsibility for the appraisal lies with the lead TLB. Advice should be sought as required from finance staff, TLB Appraisal and Evaluation teams, Defence Economics, and other specialists.

Planning

23. <u>It is important that appraisal is carried out in an open minded and objective manner, rather than used to support a decision which has already been made</u>. The appraisal should be carefully planned. The sponsor should ensure that the necessary resources are provided to carry out a thorough appraisal at the right time.

24. As part of the planning process the sponsor needs to consider who should be consulted and when, and to allow adequate time for this consultation. It is good practice to identify who will be involved in the eventual approval of the project, and to make sure that their staffs are consulted on the appraisal in draft and are content with it. That should reduce the risk of having to respond at short notice to queries or objections which are raised on the final submission, when a decision is needed urgently.

25. Care should be taken not to constrain unduly the conduct of the appraisal, for example by setting terms of reference that specify particular options, or a particular appraisal timescale.

Cases for Ministers

26. Particular care is needed in cases that go to Ministers for their approval. The investment involved may be quite small in financial terms, but these cases can be sensitive - because they involve redundancies or impact on the local economy, or because there is political interest in the subject. The Minister will undoubtedly seek advice from the appropriate Central staffs; so the sponsor of the project should ensure that these staffs

have the opportunity to see the submission and supporting appraisal in draft, and to resolve any points of difficulty.

27. It is embarrassing to the Department when flaws in an appraisal are detected only after a submission has gone to Ministers. Likewise, it is embarrassing to Ministers when flaws are not found until after the Minister has gone public, say by approving the issue of a consultative document. Ministers are entitled to a better service from the Department. No submission should be put to Ministers until the sponsor is entirely confident that the submission and supporting appraisal will stand up to scrutiny.

Scrutiny

28. Once an appraisal has been completed, both it and the recommendation for action arising from it must be independently scrutinised, in order to protect the position of the Budget Holder, and to ensure that value for money is likely to be achieved. This scrutiny role is often filled by the Budget Manager. Additional information on Budget Holder/Manager responsibilities can be found in JSP 462.

29. Scrutiny should not be limited to the recommendation for action, but should encompass the requirement itself. Requirement scrutiny is designed to ensure that only fully justified requirements, which demonstrably contribute to the organisation's agreed outputs, are approved. A financial scrutiny is carried out to ensure that approved requirements are affordable, that they are regular and proper charges to the Defence Budget, and that they represent value for money. Scrutiny should also consider the options rejected, and must be completed before the proposal passes up the approvals chain.

Role of Defence Economics

30. Defence Economics is responsible for the formulation and dissemination of policy on Investment Appraisal and Evaluation throughout the Department, and the Chief Economist represents MOD in discussions with HM Treasury about interpretation of, and addition to, the Green Book.

31. Defence Economics endorsement of all IAs which are to go to Ministers, the Investment Approvals Committee (IAC), and its delegated Authority or which will support submissions that will do so is required. Defence Economics will provide advice, assistance and Scrutiny for all Centrally Approved cases. Early engagement is recommended, and regular contact should be maintained with Defence Economics throughout the period up until the main decision point. Defence Economics also has a formal scrutiny role in the assessment of benefits presented in cases submitted to the IAC.

32. Defence Economics' advice and assistance may be sought on any other appraisal though requests should normally be routed through the relevant TLB focal point. Defence Economics will review a sample of such appraisals for DG Finance's Annual Health of Financial Systems report.

TLB Appraisal and Evaluation Teams

33. Appraisal and evaluation teams, within each TLB, act as a focal point for advice and expertise on these subjects and Scrutiny, where they fall within the TLB's delegated authority. Staff should seek guidance from these teams in the first instance, and at an early

stage. Proposals involving potentially novel or contentious expenditure must be brought to their attention as soon as possible.

34. SFOs and Agency Chief Executives are responsible to DG Finance for the coverage and quality of investment appraisal throughout their areas of responsibility. They should make arrangements for monitoring, and should make sure that they are made aware of any decision which runs counter to the conclusions of an investment appraisal, and any case where significant expenditure is committed without appraisal. They are required to cover investment appraisals and evaluations in their annual reports to DG Finance on the Health of the Financial Systems in their areas.

What is Evaluation?

35. Evaluation is the retrospective analysis of how well a project, programme, or policy is delivering against its performance, time and cost parameters.

36. When decisions have been taken and implemented, it is then important to monitor and evaluate the outcome. Only in this way can we hope to learn from our experience, avoid mistakes, and improve the quality of future management decisions.

What is the Purpose of Evaluation?

37. A fundamental requirement of HM Treasury delegation is that spending proposals are subject to effective appraisal and evaluation. Effective evaluation reinforces the accountability of Budget Holders for the resources under their control.

38. The main purpose of evaluation is to ensure that good practice is perpetuated, lessons are learned, and the Department avoids repeating costly mistakes. It is not a tool for apportioning blame, but a vital source of information for management decision making. It should also lead to improved project control and governance, and is essential to be able to gauge the level of optimism built into project estimates.

39. Evaluation is sometimes seen as a burdensome chore, tying up scarce resources for no immediate benefit. However, by analysing what went right and what went wrong on a project, and why, future performance can be improved and more value obtained from the defence budget. <u>Evaluation should not be viewed as a post-mortem, but rather as a means of learning from experience.</u>

What to Address in an Evaluation

40. An evaluation should address three distinct and interlinked elements:

a. Technical requirements and operational capability
b. Financial and commercial control
c. Project governance and control

41. The evaluation should assess what went well and why, and what didn't go well and why within all three elements. A good evaluation distinguishes between what has happened as a result of active management of the project, and what has happened because of unforeseeable external factors. The temptation to attribute, unfairly, successes to the former, and failures or problems to the latter should be avoided, if the evaluation is conducted objectively. A suggested template for evaluation is provided at Annex to Part 2, chapter 2.

When to Undertake an Evaluation

42. Every project, programme, or policy requiring an appraisal should be evaluated. The extent and depth of evaluation should be commensurate with the value, length and complexity of the project, programme or policy to ensure the efficient allocation of resources.

43. A straightforward, low value project may only require a short evaluation at the end of the project life. For larger, longer running projects, programmes, and policies, greater depth of evaluation will be required. For these, an evaluation should be undertaken after each major stage of the project lifecycle e.g. initiation, initial gate, main gate, contract award, in-service, and on disposal or termination. This should be planned for at project initiation, given that on any project, resources are limited.

44. Performing regular reviews at predetermined stages in the project lifecycle, where the team considers performance against expectations and discusses the reasons for differences, enables the timely identification of lessons that can be applied to the next stage of the project life cycle. Evaluation should also be carried out at other major project milestones e.g. a project manager leaving, in order to prevent a loss of valuable project knowledge.

45. Any project that stops or experiences any issues not previously envisaged should conduct a detailed evaluation of the issues, causes and remedial actions, including the effectiveness of remedial actions.

Who is Responsible for Undertaking Evaluations?

46. Evaluation is a line management responsibility, and thus the responsibility for evaluation rests with the management area responsible for the project, programme or policy. Evaluation should be carried out by existing resources, with external facilitation or support if required, and be an integral part of the project process. The majority of effort and activity should complement other project controls such as risk management, stakeholder involvement and communication.

47. If a project is sponsored in one management area but executed in another, the two areas should agree on who is to undertake the evaluation. However, since the ultimate objectives of the project are those of the sponsoring area, the presumption should be that it is this area that carries out the evaluation. For example, a procurement project should be evaluated by the Customer for the equipment, and an accommodation project by the Garrison Commander. The Senior Finance Officer (SFO) in a TLB is responsible to DG Finance for ensuring the robustness of systems to support evaluation, as is the Chief Executive in an Agency. As part of this responsibility, SFOs and Chief Executives should ensure that procedures are in place in their areas to manage the process of project evaluation.

Disseminating Lessons Learned

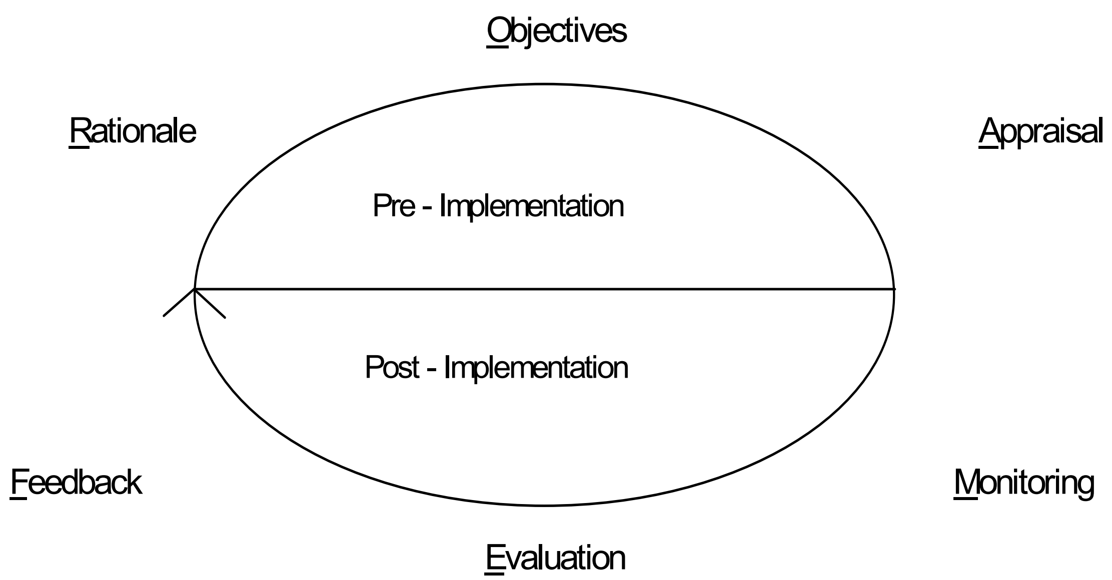
48. One of the key reasons for undertaking evaluations is to learn lessons for the future. Lessons learned should be captured and disseminated across TLBs within the Department and with industry at various levels identified in the governance. Project staff should include plans for the conduct of an evaluation in the original appraisal, rather than simply stating that an evaluation will be carried out.

49. The distribution of the evaluation should be such that lessons learned are communicated to others likely to benefit. The evaluations of projects, policies or programmes that were reviewed by Defence Economics prior to their approval should also be forwarded to Defence Economics for collation and analysis of key lessons.

Appraisal and Evaluation within the Management Framework

50. Both the appraisal and evaluation form part of a framework for management of policies and programmes called the **ROAMEF** Framework (see *Figure 1a*). **ROAMEF** stands for Rationale, Objectives, Appraisal (of options), Monitoring, Evaluation and Feedback. Rationale is the need for the policy or programme. The Objectives flow from the need identified as being unmet, whilst Appraisal is the assessment of the possible options to meet those needs. Monitoring is the continuous review of the project operation, and *evaluation* is the assessment of the full effects of the project against a previously determined baseline. Feedback is communicating the results of evaluation to those concerned with the original project or with related projects. HM Treasury recommend this framework is applied by all Government Departments.

Figure 1a: The ROAMEF Framework



2 The Elements of Business Cases and Appraisals

A business case must be prepared for all proposals that would involve the commitment of resources or which would result in measurable benefits. The business case must include five key elements:

a. The Strategic Case;
b. The Economic Case;
c. The Commercial Case;
d. The Financial Case;
e. The Management Case.

An investment appraisal addresses the Economic Case. A well-conducted investment appraisal should include the following elements in sequence, addressing key issues relevant to each. These are:

a. the options being considered and the reasons for their selection;
b. short-listing of the options;
c. the costs and benefits of the various options;
d. assessment of risks;
e. sensitivity analysis;
f. other factors leading to the choice of a recommended option.

What Is A Business Case?

1. The Business Case is a management tool and is developed over time as a living document as the proposal develops. The Business Case keeps together and summarises the results of the analysis needed to support decision making in a transparent way. In its final form it becomes the key document of record for the proposal, also summarising objectives, the key features of implementation management and arrangements for post implementation evaluation.

2. Business cases can cover a wide range of types and levels of project, programme, or policy. The effort expended on developing the proposal should be proportionate to the likely costs and benefits.

Business Case Structure

3. Business cases should contain the five elements defined by HM Treasury's best practice 'Five-Case' Model. These are:

a. **The Strategic Case.** This will set out why the proposal is needed, the background to the proposal, the requirement, any over-riding and binding constraints, and any dependencies.
b. **The Economic Case.** This considers the options for delivery and the assessment of Value for Money (VfM) (see Chapter 1, paragraph 7).

c. **The Commercial Case.** This sets out the procurement strategy and considers the commercial viability of the proposal.
d. **The Financial Case.** This establishes the affordability and financing of the proposal.
e. **The Management Case.** This sets out how the proposal will be delivered in project and programme management terms, and the plans for evaluation of the proposal.

4. All of these aspects are important; however, their size will vary from proposal to proposal depending upon its nature and complexity. Some less complex business cases particularly those not involving significant new procurement, new systems or new building construction may need little or nothing by way of a commercial case and require a less complex management case.

5. Business Case Templates for proposals that will be approved within TLB or Project Team delegation are available from Individual TLB Approval Teams. Cases seeking central approval must consult the Approvals Guidance.

The Development of the Business Case

6. The Business Case should develop iteratively over time, often in two distinct stages with more detail being provided at each stage.

Initial Gate Business Case (IGBC)

7. The Initial Gate business case seeks approval to undertake an assessment of the options (the Assessment Phase), within a defined Performance, Cost and Time (PCT) envelope, in order to determine which can best meet the requirement i.e. to reach, support and achieve a main investment decision at Main Gate. It includes an assessment of the risks and benefits of options for presentation at Main Gate. Issues should not, except in exceptional circumstances, be addressed in terms of a particular solution. The aim is to keep the options open, with specific recommendations being more appropriate to Main Gate approval.

8. An Initial Gate approval is normally required before formally engaging the private sector (e.g. by advertising the requirement in the MOD Contracts Bulletin and the Official Journal of the European Union). Exceptionally, the Initial Gate may be omitted for lower value and low risk cases with the agreement of the relevant Approving Authorities.

9. The key elements of the IGBC are:

a. The Strategic Case – outline the capability gap and the requirement to make a robust case for change. Determine benefits, risks, constraints, and dependencies;
b. The Economic Case – set out the long-list of alternative options, and an initially recommended shortlist for further examination. Indicative costs and benefits for short-listed options should be provided;
c. The Commercial Case – set out a procurement strategy for the Assessment Phase (or equivalent);
d. The Financial Case – discuss the likely affordability of the proposal,
e. The Management Case –outline how the project will be set up and managed. Set out an exit strategy.

Main Gate Business Case (MGBC)

10. The purpose of the MGBC is to revisit the IGBC in more detail and to identify a preferred option which demonstrably optimises VfM. It also sets out the likely deal; demonstrates its affordability; and details the supporting Procurement Strategy, together with management arrangements for the successful rollout of the proposal.

11. Main Gate constitutes the main investment decision where the Department commits to the full cost of the programme. This is usually taken to be the point at which a Preferred Bidder (PB) is selected. By this stage, the risks remaining in the project should be well understood and there should be sufficient confidence to take a Main Gate decision.

12. The key elements of the MGBC are:

a. The Strategic Case – revisited and revised if required.
b. The Economic Case – the value for money position is clear, supported by an endorsed investment appraisal completed in accordance with JSP 507, or a should-cost model for single-source cases;
c. The Commercial Case – the procurement strategy is clear and indicates whether there will be any further decision points post Main Gate;
d. The Financial Case – affordability and funding issues resolved;
e. The Management Case – the detailed plans for delivery and arrangements for the realisation of benefits, management of risk; and post evaluation are recorded.

The Strategic Case

13. The strategic case sets out the case for the proposal. It should set out the background to the proposal and the objective to be achieved. The fit with the wider public policy objectives and the department's corporate plan should also be explained. Any constraints to competition should be explained, and any interaction with or dependency on any other proposals, e.g. the fit with published targets such as Public Service Agreements. Lessons learned from previous experience in this area should be briefly set out.

Background

14. The background to the project, programme, or policy should be explained in sufficient depth so that the reader can understand why the need has arisen, and why the requirement (which should be stated explicitly) has been defined as it has. Material that is merely of historical interest should be excluded.

Requirement

15. It is necessary to establish how individual projects are linked to delivering final Defence outputs. Procuring an asset or service, or putting in place a scheme is not an appropriate requirement in itself. The requirement should generally be predicated on the need to, for example:

a. provide further economies in the provision of an existing service;
b. improve business effectiveness and service quality in terms of the required outcomes;
c. improve efficiencies in the throughput of services;

d. meet statutory requirements and obligations;
e. meet policy changes;
f. deliver new business and operational targets.

16. The requirement must be clearly set out so that its achievement can be monitored. Clarity in the setting of the requirement allows for scrutiny, and also assists in identifying the full range of options which may be available to deliver the proposal.

17. The requirement should be expressed clearly and concisely in terms of the outcomes, effect, or service to be delivered. It must not be expressed in a way that anticipates or pre-empts a particular solution.

18. A clear statement of requirement is necessary for three main reasons:

a. **Generating options.** Clearly defined objectives make the process of generating options much easier. Requirements should reflect only the absolute essentials. Options can be assessed against the objectives to see if they are worthy of consideration. Ill-defined objectives are likely to lead to unnecessary work; time spent considering unsuitable options is time wasted. However, objectives should not be set so tightly that they exclude otherwise worthwhile options and lead to costly re-workings at a later date. Care must be taken to ensure that options are not solution specific, nor should options be excluded solely on the grounds of affordability in an existing budget.

b. **Selecting the Preferred Option.** The selection of the preferred option involves an assessment of all the costs of delivering outputs. With clear objectives and an indication of their relative importance, it will be easier to identify and quantify all the costs and benefits involved.

c. **Evaluation.** Evaluation is the process of measuring the project outcomes against those forecast in the investment appraisal or against some other agreed baseline. The absence of detailed objectives makes this task difficult, if not impossible.

19. In the equipment environment a capability audit would be used to establish the Single Statement of User Need (SSUN). This sets the scope for the User Requirement Document (URD) in which more detailed and individual requirements and constraints are set out. More information can be found on the AOF (aof.mod.uk).

Constraints

20. Open and fair competition is a fundamental component of MOD acquisition policy in delivering affordable defence capability at overall long term VfM, and is a legal requirement in many circumstances. Competitive procurement helps to deliver VfM because it gives suppliers an incentive to reduce costs, increase productivity and encourage innovation by continually benchmarking them against their competitors.

21. The ability to run a competitive procurement may be affected by defence strategic considerations and market constraints. Project teams should identify whether any constraints apply, and where they do, seek early engagement with Defence Economics or the relevant TLB Appraisal team, particularly where the existence of constraints potentially

results in only one option being available to meet the requirement (see Chapter 3, paragraph 28.

Dependencies

22. Any actions or developments required of others should be considered if the ultimate success of the project, programme, or policy is dependent upon them.

The Economic Case

23. This is the essential core of the business case and sets out the demonstration of value for money. This section of the business case assesses the economic costs and benefits of the proposal to society as a whole, and spans the entire period covered by the proposal.

Options

24. Options should be generated with reference to the requirement. As wide a range of options as possible should be considered in the early stages to reduce the likelihood of expensive and time consuming revisiting at a later date. Involving all those who have a legitimate interest in the outcome of the decision may help in this respect.

25. The options considered in the appraisal should be clearly and simply described, and the reasons for their selection should be fully explained. The list of options must include an option that will act as the baseline for determining value for money. Depending on the circumstances of the case, this may be either:

a. **'Do nothing'** i.e. where it is feasible to cease an activity; or
b. The **'status quo'**, i.e. continuing the existing service at the same level and in the same way; or
c. **'Do minimum'**, i.e. doing the least that has to be done to comply with the requirement (for example meeting minimum Health and Safety standards).

Consideration of the potential for private sector involvement in delivering the requirement should also be considered at this stage (see Chapter 3, and Part 2, Chapter 8).

26. Those involved in generating options should be imaginative, not always opting for the obvious solutions. For example, if appraising a collocation project, sites other than those currently occupied should be considered. (Early contact should be made with the Defence Infrastructure Organisation (DIO) (Estate Rationalisation) team, who will be able to advise on the availability of Defence sites to meet specific requirements.) The availability of comparable facilities in other Commands and Services should be explored if the provision of new facilities is being contemplated. Options involving varying the scale or timing of a project should be explored as a means of potentially increasing VfM, as should all the individual elements.

27. Usually there will be a wide range of possible solutions to a specific problem. <u>It will be rare for there to be only one possible option</u>, and where this is the case, robust justification will be needed. You should consult your SFO, TLB Appraisal and Evaluation team, or Defence Economics, in such cases. Where there is genuinely only one possible option available to meet the identified objectives, <u>a costed investment appraisal is not required</u> (see Chapter 3). However, it is still important to establish value for money, and the affordability of that option.

Examples of options for a collocation project:

a. Refurbish existing facilities;
b. Maintenance by the private sector;
c. Options to rent, build or purchase;
d. Varying locations or sites;
e. Provision of the service or facility by the private sector;
f. Co-location with other agencies

Short-listing the Options

28. It is sensible to appraise in full (i.e. explicitly work through all the steps described in this guide) only those options that are considered feasible. However, the reasons for rejecting options without appraising them fully should always be made explicit. Reasons for exclusion might for example be obviously poor VfM or unacceptable or unmanageable risks. Potentially viable best VfM solutions must not be eliminated at this stage.

29. The short-list must:

a. Include the 'do nothing', 'status quo', or 'do minimum' option, which provides the benchmark for assessing value for money; and,

b. Transparently record the reasoning and evidence behind the rejection of each excluded option.

30. The shortlist must not:

a. Rule out options because they are "radical", or because their appraisal will be difficult, given the uncertainties that require resolution, or because they involve confronting vested interests;

b. Reject options only because they have fewer benefits than some other more costly option;

c. Prematurely discard options; or,

d. Reject options on grounds of affordability, without confirming the overriding nature of the budget restraint.

31. Options should not be discarded without being appraised simply because they cost more than the budget provision in a specific year, or for a particular item, because they may nevertheless be better value for money in the longer run than 'affordable' options. In principle, funding can be increased by re-allocating funds. Ultimately, a judgement may be made that funding constraints are such that a second best option must be adopted. But unless the 'unaffordable' option is included in the appraisal, it will never be possible to make an informed judgement on the best way ahead. It is essential that the appraisal provides an audit trail that demonstrates that the full range of options has been considered; so options should not be ruled out at an early stage on affordability grounds.

32. If it will be difficult to reverse any decision, it may be particularly important to consider deferral or implementation in a more flexible manner. All short-listed options must be capable of financial and non-financial analysis. However, not all need be subjected to a

full appraisal (for example, because of their obvious inferiority). Best practice requires a presentation of a full range of options, if only in broad outline.

Costs and Benefits

33. Costs and benefits (quantified and unquantified) of each option should be set out clearly. To guard against error, and to ease the scrutiny process, costs and benefits should be presented on a 'full cost' basis rather than as differences from a baseline. Although decision-making is ultimately concerned with the differences between the costs of the options, and the two methods ought to give the same result, carrying out the costing on a 'differential' basis has the following disadvantages:

a. There is a risk of making mistakes, either omitting items or double counting them as costs in one option and benefits in another;

b. Important information may be lost - a difference in staff costs of £100,000 per annum is much more significant if the total staff cost is £1m a year than if it is £10M;

c. It becomes very difficult for someone scrutinising the appraisal to understand the figures and to form a judgement on the soundness of the appraisal.

34. There is a judgement to make about the amount of detail to include in the presentation. Investment appraisals should include discounted cash flow tables in which the costs and benefits of each option are expressed in real terms (i.e. constant price levels excluding general inflation). There should be sufficient detail for the key cost drivers to be identified, and to give the reader confidence that all cost elements have been included, but not so much that important information is difficult to disentangle. The assumptions on which the costings have been based should be clearly documented, and explanatory notes should give sources for all data.

35. It is not credible that future costs can be estimated to the nearest pound. Often estimates for major projects will only be accurate to the nearest £100,000 or £1M and should be rounded accordingly. Presenting more detail results in spurious accuracy and simply clutters the presentation. In smaller projects it may be appropriate to round to the nearest £1,000. The results of sensitivity and scenario analyses should be included in presentations and summary reports, rather than just single point estimates of expected values. It is also important to check that spreadsheets, after reduction and photocopying, can be read easily.

36. The level of effort to identify and quantify costs and benefits for each option should be commensurate with the scale and complexity of the project. When identifying costs and benefits, consideration should be given to whether options might generate losses or special payments.

Optimism Bias and Risk

37. In appraisals, there is always likely to be some difference between what is expected, and what eventually happens. As a result an assessment of the risks associated with each option must be made. At the early stages of a project, programme, or policy, when risk management proposals are relatively undeveloped, an explicit allowance for optimism

bias (see Part 2, chapter 6) should be made against all options, regardless of the size or complexity of the proposal.

38. Optimism bias is the demonstrated, systematic, tendency for project appraisers to be overly optimistic about key project parameters. Appraisers tend to overstate benefits, and understate timings and costs, both capital and operational.

39. As the business case develops, a more detailed assessment of individual risks and risk management will be required for larger projects. In these cases an optimism bias assessment will then be used as a 'sanity check' of the risk assessment. For small projects the risk premium may continue to be encompassed by a general uplift to offset and allow for undue optimism bias. As costs are firmed, the level of optimism bias will decrease (see Part 2, Chapter 6).

Sensitivity analysis

40. All appraisals must contain a sensitivity analysis to test the vulnerability of options to future uncertainties, such as changes to flying hours, equipment numbers, or Out of Service Date (OSD). The sensitivity analysis should be based on plausible variations to the assumptions made, perhaps based on evaluation of previous projects. The values at which key variables would cause costs or benefit values to change enough to affect the choice of preferred option should be explored. For example, how much would the cost of procuring a new IT system have to rise to outweigh the expected cost-savings it will provide? (For further information see Part 2, chapter 6, paragraph 73).

Other factors

41. The BC should show that every effort has been made to quantify all relevant costs and benefits. Sometimes there are genuinely unquantifiable costs and benefits associated with a proposal. Where this is the case they should be clearly explained along with the reasons why quantification can not reasonably be made. Where they are relevant to the choice of option, alternative methods may be used to support option selection. It is important however that such analysis is transparent and that it is not structured in such a way as to produce a biased or predetermined result.

42. Any such factors considered relevant to the decision should be agreed with Defence Economics or the relevant TLB Appraisal and Evaluation team (see Part 2, chapter 5 for further details).

Whole Economy Impacts

43. MOD investment appraisals are concerned with appraising public value; that is the value to UK society of a proposal or option rather than just to the Exchequer or the Department. Wider social costs and benefits should only be included in an investment appraisal where:

a. They can be reliably estimated on a sound empirical basis;
b. Where they are material to the proposal; and
c. Where it is proportionate to do so bearing in mind the costs, benefits and risks of the proposal and the time and resources available.

44. In practice, wider economy impacts are not included in investment appraisals, even when the choice is between domestic and overseas options (see Part 2, Chapter 5, paragraph 27).

Recommendation

45. The recommended solution should be supported by a transparent and logical argument showing clearly why it has been chosen, and how the various factors (the costs and benefits covered by the appraisal, the risks and uncertainties involved, other business/operational factors, security, wider policy issues and affordability) have affected the choice.

Writing up the Appraisal

46. For small projects the presentation of the appraisal results covering these elements can be incorporated into the business case. However, for larger projects, particularly those covered by the Approvals Guidance, separate Investment Appraisal and Business Case documents should be produced. When preparing separate Investment Appraisal and Business Case documents, it is not necessary to duplicate information required in the Business Case within the Investment Appraisal.

The Commercial Case

47. The commercial case is concerned with issues of commercial feasibility and sets out to answer the question “can the proposed solution be effectively delivered through a workable commercial deal or deals?” The first question, therefore, is what procurement does the proposal require, is it crucial to delivery and what is the procurement strategy?

48. The procurement strategy should be clearly set out in the commercial case and the ownership of any assets should be clearly defined and key contractual issues identified and explained, together with the proposed solution.

49. The allocation of risk must be clearly explained and the business case should include a risk table showing risk allocation and the steps which are being taken to mitigate risk. Any personnel implications also need to be fully explained and if TUPE is involved this has to be properly included in the delivery plans (see Part 2, chapter 4). (TUPE refers to the Transfer of Undertakings (Protection of Employment) Regulations 2006).

50. The commercial case should show key contractual milestones and delivery dates and should clearly set out the agreed accounting treatment. Detailed guidance can be found in the Acquisition Operating Framework (AOF) Commercial Toolkit.
http://www.aof.dii.r.mil.uk/aofcontent/tactical/toolkit/index.htm

The Financial Case

51. The financial case is concerned with issues of affordability, and sources of budget funding. It covers the lifespan of the scheme and all attributable costs. The case needs to demonstrate that funding has been secured and that it falls within appropriate spending and settlement limits. The focus in this section of the case is on capital and resource requirements (near-cash or non-cash) and so here VAT and capital charges are included. The financial case is concerned with the budgetary impact.

52. Issues in addition to the proposal's affordability are:

a. does the financial case identify and fill any funding gaps,
b. does it contain provision for dealing with the financing of any time or cost overruns,
c. does it fully explain and estimate any contingent liabilities that may result from the proposal?

The Management Case

53. The management case is concerned with the deliverability of the proposal and is sometimes referred to as programme management or project management case. The management case must clearly set out management responsibilities, governance and reporting arrangements, if it does not then the business case is not yet complete. The Senior Responsible Owner should be identified.

54. The management case should include a delivery plan with clear milestones which relate to but are at a more detailed level than contractual milestones. The management plan applies to any programme or projects required by the proposal. Programme and project plans must include business assurance arrangements. Where so-called controlled environments such as information and communications technology are involved or complex business systems then the use of PRINCE2 methodology is mandatory for programme and project management. Where significant change management is involved, a change management and stakeholder management plan should be included.

55. The management plan should also set out clearly any OGC Gateway Review arrangements, and should contain a benefit realisation plan and benefit register. The management plan should also include a contract management plan and arrangements where contracts are required. There should be a contingency plan with arrangements and plans for risk management and a risk register.

Monitoring and Evaluation

56. All business cases should include a plan for monitoring their effects and a plan for subsequent evaluation. This should be more than an assertion that an evaluation will be carried out: it should show how the success or failure of the project will be measured; what data will be needed to support that measurement; and how that data will be collected; and when and by whom this is to be undertaken. These should include provision in both economic and financial cases for the associated monitoring and post implementation evaluation costs. This monitoring and feedback provision is essential to the longer term evolution of evidence based policy and without it the business case is not complete.

Annex A: Business Case Checklist

The following checklist highlights some of the key points that should be considered when preparing a business case.

The Strategic Case

Justify the requirement

- What has generated the need for this expenditure?
- What capability gap has been identified?
- Express the requirement clearly and concisely – without a full understanding of the requirement, it is difficult to identify all the possible methods of addressing and meeting the need.
- What are the key objectives of the proposal?
- What outputs are required? When?
- Do not pre-empt the solution – ensure the requirement is expressed in output related terms that do not unnecessarily restrict the number of possible options.
- Decisions should not be taken prior to the completion of the IA.
- Are constraints and dependencies identified and managed?

The Economic Case

Develop possible options

- Need to consider all possible options for achieving the objectives.
- Always include do nothing / status quo / do minimum options.
- Options should not be constrained by affordability.
- When considering options for private sector delivery a value for money benchmark must be developed.
- There should be no presumption either in favour or against in-house versus private sector provision.

Short-list the options

- No option should be rejected without properly supported explanations.
- Acceptable reasons for rejection include similar but inferior to another option, or not feasible.
- Not acceptable include discarding on grounds of affordability or not fully meeting user requirement.
- All assumptions should be supported.

Time horizon

- A realistic timescale should be chosen depending on the nature and life of the project, e.g. life of the major fixed asset or period over which the service is required.
- Could involve replacement of assets in some options, e.g. computer systems.

Identify and quantify costs and benefits

- Costs and benefits should cover the whole life of the project and consider all impacts of the project regardless of budget area.
- Ignore sunk costs.
- Ensure costs and benefits are expressed in “real terms” (see Part 2, chapter 1).
- Firm price contract costs should be deflated prior to discounting.

- Include opportunity costs, running costs and savings / receipts as appropriate.
- Include residual values where appropriate.
- “Contingencies”, “premia”, “running costs” or other generic headings should always be supported and explained.
- Use a 3.5% Discount Rate to calculate Net Present Value (NPV). (For project durations exceeding 30 years refer to Part 2, chapter 1, paragraphs 15 - 18).
- Include allowance for relative price inflation as appropriate.
- Exclude interest on capital, depreciation, VAT and general inflation.
- Ensure data and assumptions are recorded and agreed by stakeholders.
- Common costs should ideally be included (see Part 1, chapter 1, paragraph 43).

Risk Assessment

- In larger projects, key risks should be assessed, evaluated and if possible, quantified, with particular emphasis on how it is intended to mitigate or manage them.
- An optimism bias assessment should be undertaken on all options, where appropriate.
- Is there a risk allocation table?

Sensitivity Analysis

- Sensitivity analysis of key variables should be undertaken in all cases.
- Plausible variations to assumptions should be applied to test the impact on the ranking of options.

Non-quantifiable factors

- Are there any costs and benefits relevant to individual options that have not been quantified in the appraisal?

Recommendation

- Of the options considered which represents best value for money for the Department?
- If this is not the recommended route, state the justification

Working papers

- Should be clear and retained for audit purpose. They will also potentially assist in any Project Evaluation.

Defence Economics Consultation

- Defence Economics must be consulted on appraisals that will eventually be presented to Ministers, the Investment Approvals Committee, and its delegated Authorities or which will support submissions that will do so. Defence Economics will provide advice, assistance and scrutiny for all Centrally approved cases.

The Commercial Case

- Is the proposal commercially feasible / deliverable?
- What procurement is required; goods, services, land, buildings?
- What is the procurement strategy?
- What are the key contractual issues?
- There must be clear contractual key milestones and delivery dates
- There must be clear agreed accounting treatment
- What if any are the personnel implications and is TUPE applicable?

The Financial Case

- Focus on affordability; is full budget funding secured and budgeted by all parties?
- What are the impacts on income/expenditure a/c and on balance sheet if applicable?
- Are potential cost over runs provided for
- Are there any contingent liabilities?
- Any guarantees?

The Management Case

- Is the proposal practically deliverable and what are the delivery plans?
- Are there clear delivery dates and detailed milestones?
- Does the proposal require programme or project management techniques?
- Is there a contract management plan?
- Change management requires a change management plan!
- If in a controlled environment such as ICT use of PRINCE 2 is mandatory!
- Does the plan include clear arrangements for OGC Gateway peer reviews?
- Is there a contingency plan with arrangements & provision for risk management?
- There should be a benefit realisation table and plan.

Evaluation plan

- Does the plan include monitoring arrangements (who when how and costs)?
- The Business Case should include a plan for any subsequent evaluation, i.e. what is to be evaluated, when will they be carried out, and by whom? (see Part 2, chapter 7)

3 Involving the Private Sector

The extent of involvement of the private sector can vary from minor elements of a proposal being contracted-out through to full privatisation, with various forms of contracting, outsourcing, partnering and PFIs in between.

Careful consideration needs to be given to which procurement route is likely to be most effective. In some cases, the appropriate balance between public and private sector provision will be clear. In others, the best solution must be identified across a range of public, private and partnership options. The key objective is to ensure that taxpayers get value for money.

Introduction

1. Private sector provision may be more likely to provide a better solution where the scope for the following is greatest:

a. Innovation to reduce costs or to improve observable outcomes;
b. Generating additional revenue flows by sales to third parties;
c. Reduction in risk of cost overrun or benefit shortfall;
d. A contractor is able to exploit economies of scale in the provision of services (e.g. IT support or facilities maintenance);
e. Savings in whole life costs and/ or for improved outcomes through effective design (e.g.: where a broad range of services may be provided in association with an asset, or when many inputs must be integrated in delivering a service, or where whole life and operating costs are importantly determined by good design);
f. Clear specification of quality standards in absolute terms or in terms of client satisfaction;
g. Ability of private sector to control discrete elements of the project without excessive oversight or interference; or,
h. Clear boundaries and interfaces between public and private sectors.

2. Provision by the private sector may be less appropriate where:

a. Risks which threaten the viability of a project are outside the control of the contractor (and these risks cannot be separated contractually from the project);
b. The predominant risks are ones where the public sector has the comparative advantage in managing them;
c. A large degree of discretion is required in determining the quality of services, and quality is not observable; or,
d. Bidding costs are large in proportion to the value of the project (although there may be means of reducing these costs).

Risk transfer

3. When faced with significant risks, transferring part or all of it to the private sector should be considered. The governing principle is that risk should be allocated to whichever party from the public or private sector is best placed to manage it. The optimal allocation of

risk, rather than maximising risk transfer, is the objective, and is vital to ensuring that the best solution is found. Accordingly, the degree to which risk is transferred depends upon the specific proposal being appraised.

4. Successful negotiation of risk transfer requires a clear understanding by the procuring authority of the risks presented by a proposal, the broad impact that these risks may have on the suppliers' incentives and financing costs, and the limits to risk transfer which might still be considered for value for money.

5. Where the private sector has clear ownership, responsibility and control, it should be encouraged to take and mitigate all of those risks it can manage more effectively than the procuring authority. If the procuring authority seeks to reserve many of the responsibilities and controls that go hand-in-hand with service delivery and yet still seek to transfer significant risk, there is a danger that the private sector will increase its prices.

6. A risk allocation table can be a useful tool to identify the bearer of each risk relevant to a proposal. An example of this is set out below:

Risk Allocation Table				
Risk	**Scale**	**Bearer**		**Key Issues**
		Purchaser	**Provider**	
Obsolescence	Low		√	Assets require low levels of technology
Demand Risk	Med	√		…
Design risk	High		√	…
Residual Value	Low	√		…
3rd party revenues	Low		√	…
Regulatory change	High	√		…
Etc	…	…	…	…

Competition Policy

7. Open and fair competition is a fundamental component of MOD acquisition policy in delivering affordable defence capability at overall long term Value for Money (VfM), and is a legal requirement in many circumstances. Competitive procurement helps to deliver VfM because it gives suppliers an incentive to reduce costs, increase productivity and encourage innovation by continually benchmarking them against their competitors. Competitive procurement is MOD's default procurement route.

Legal Obligations

8. The following Procurement Law applies:

a. MOD is required by the Public Contracts Regulations 2006 (also known as the Procurement Regulations) to advertise and to run a competitive procurement process for contracts for goods, works or services except where exempt under Article 346 of the Treaty for the Functioning of the European Union.

b. MOD procurement is also subject to EU Treaty principles, including equal treatment, transparency and non-discrimination that should apply to all MOD procurements that fall within the scope of the Treaty even where the Procurement Regulations do not apply.

Non-legally binding obligations

9. Teams should continue to adhere to the European Defence Agency's Code of Conduct on Defence Procurement to contract for goods and services that benefit from the Article 346 exemption and are above the threshold of Euro 1 million.

The benefits of competition

10. Competitive procurement delivers benefits by tackling two basic problems. Firstly; there is an asymmetry of information between MOD and its suppliers in that the latter are far better informed about the likely cost of providing a particular capability, yet have an incentive to overstate these costs to the customer in order to increase their profits. Secondly, once a contract has been signed suppliers may have an incentive to act in ways which benefit their interests at the expense of the customer.

11. Competition partly resolves these issues by providing a benchmarking function in that it allows the MOD to compare prices across a range of suppliers, giving it more information. Firms competing for the contract have an incentive to bid as low as possible (whilst still earning an acceptable amount of profit) in order to maximise their chances of winning. This will tend to force firms' bids down closer to their true costs of production making them a better indicator of their costs.

12. After a contract has been signed, competition exerts pressure through a different mechanism. If a supplier knows that the MOD has a range of potential alternative providers, the incentives for them to engage in behaviour which might lead to unsatisfactory performance and hence risk them losing future business, are reduced.

Limitations of competition

13. The key limitation on the use of competition in defence procurement is the small number of potential suppliers, with most areas of the market having only a handful of firms capable of acting at the prime contractor level. This is exacerbated by significant barriers to entry in the form of the large up-front capital investments and the required technological expertise. These make it difficult for new firms to 'break into' the market, making the consequences of a firm exiting the market on the level of competition more severe.

14. A consequence of this is that MOD procurement decisions can have a significant impact on the structure of the market. As a result of losing a particular competition a firm may no longer have sufficient orders to sustain its industrial capacity. The nature of the competitive process means that unless they can somehow sustain this capacity the firm will slowly be driven out of the market by their rivals, reducing the level of competition in the long run.

15. This can lead to 'winner takes all' type competitions in which firms have a strong incentive to submit overly optimistic bids in order to win the contract, with the expectation

that when problems emerge in the future they will be able to renegotiate terms because the MOD is already locked into the contract and / or there are no credible alternative suppliers left in the market.

16. More broadly, the adversarial nature of competition discourages defence firms from being completely open with the MOD for fear that information might leak to their competitors, giving them a commercial advantage. Where a project contains significant technological or programme risks this reduced openness may result in problems not being identified and dealt with early, leading to shortfalls in performance on time / cost / effectiveness.

Constraints on Competitive Procurement

17. The ability to run an open and fair competitive procurement may be affected by defence strategic considerations and market constraints. Project teams should identify whether any constraints apply, and where they do, seek early engagement with Defence Economics or the relevant TLB Appraisal and Evaluation team.

18. Project teams are likely to have to justify any constraint due to defence strategic activities under a treaty exemption or general exclusion from EU procurement law. If a project team has any doubt about the application of an exemption or exclusion, they should seek legal advice from CLS-CL. If a treaty exemption or general exclusion does not apply, project teams will have to justify any single source procurement due to market constraints under Regulation 16 of the Defence and Security Public Contract Regulations (DSPCR) 2011 or Regulation 14 of Public Contract Regulations 2006.

19. As set out in the *National Security Through Technology* White Paper, published in February 2012, the principle of Open Procurement is qualified by the principle of Technology Advantage. Technology advantage comprises two elements: freedom of action and operational advantage:

a. **Operational Advantage** (Op Adv) is the ability to find and maintain an edge over potential adversaries, both to increase the chances of our success in hostile situations and to increase the protection of the UK assets involved, especially our people. Operational advantage can be based on a number of factors such as superior intelligence, training and doctrine, but is particularly important in terms of equipment and underpinning technologies;
b. **Freedom of Action** (FoA) is the ability to determine our internal and external affairs and act in the country's interests free from intervention by other states or entities, in accordance with our legal obligations. This freedom is the essence of national sovereignty. Different acquisition options offer differing levels of assurance in relation to our future freedom of action, particularly where a potential supplier is based overseas.

20. The White Paper notes that there may be occasions where we decide to protect an <u>aspect</u> of capability for national security reasons. How we choose to protect that capability will always involve a balance of risk and innovative thinking about the most cost effective solution. We may, for instance, chose to consider working with Allies, share military capabilities, or entering into arrangements to ensure appropriate levels of technology sharing and security of supply. There may also be competition law and procurement law implications to consider.

21. Where we judge that it is essential to take action to protect the UK's operational advantage or freedom of action, we expect to seek to protect up to four aspects of a specific capability by obtaining specific security of supply[1] undertakings. These four aspects are timely access to the:

a. essential skills and knowledge needed to design, develop, integrate, evaluate, support and maintain key systems and sub-systems, together with the conduct of test, evaluation, support and upgrade processes for those systems. Science, technology, engineering, and mathematical (STEM) skills are likely to be particularly important here.
b. facilities and infrastructure which support these processes including specialist manufacturing and production facilities, design systems, support
c. infrastructure, and test and integration rigs;
d. technologies critical to the design and development of key systems and subsystems; and
e. appropriate freedoms from potential legal constraints on the use of technology (including intellectual property rights) to enable the UK and its suppliers to maintain, upgrade, and operate key systems and sub-systems.

The timescales within which access is needed will be established as part of setting the requirement and the delivery strategy for that capability.

22. Further guidance to assist decision makers is provided in:
Policy Guidance – Criteria for Applying Operational Advantage and Freedom of Action in Defence Acquisition
(http://www.aof.dii.r.mil.uk/aofcontent/downloads/security/20130603_Policy-guidance-FOAOA-U.doc)

23. In exceptional cases, where it can be clearly demonstrated that it is appropriate to source an aspect of capability we need for our freedom of action or operational advantage only from within the United Kingdom, MoD will seek delivery from the UK industrial base. Competitive procurement may have to be limited to suppliers who have appropriate facilities and personnel in the UK or the contract may have to be structured so that it uses other protective measures such as firewalls between elements of the contract. An aspect of capability will be regarded as being 'retained in the UK industrial base' if the people possessing the skills and the facilities representing that capability reside in the UK and the requisite Intellectual Property RIPR can be effectively utilised in the UK. Due regard needs to be given to the impact of foreign control laws on the ability to effectively exercise the IPR and the impact this could have on third party use of the IPR for MOD.

24. The scope for full and open competitive procurement may be further influenced by the following market factors:

a. **IPR**. Access by MOD to sufficient rights to enable a third party to utilise IPR on MoD's behalf is fundamental to achieving competitive procurement for many MOD requirements from research and technology right through the procurement cycle to disposal. Where there is a sole source of supply because MOD does not possess any or sufficient IPR, or where the risk would be too great to place work with another party (for instance where Airworthiness Certification would be jeopardised

[1] *Security of Supply* is the ability to guarantee and be guaranteed the supply of goods and services that are essential to military operations to prosecute the Government's foreign and security policies.

should work be placed with a party other than the Design Authority), then teams should consider whether there is any opportunity to reformulate the requirement or obtain licensing to open up competitive procurement.

b. **Single Source Worldwide**. In some circumstances there may only be a single source of supply worldwide. If there is a single source of supply worldwide, teams should consider whether there is any opportunity to promote competitive procurement for example reformulating the requirement or stimulating the market. A detailed cost/benefit and risk analysis should be undertaken to ensure that such an approach would deliver long term VfM.

c. **Limited Market Opportunities**. There may be a lack of suppliers with the required capacity to deliver the requirement or a lack of 'real' competitive pressure in the market. Where there are limited market opportunities defence firms may find themselves in a position where a competitive procurement becomes a 'must win' situation with failure to secure a contract likely to result in a particular industrial capability being run down due to lack of work and becoming unsustainable. Given the small number of firms capable of acting at the prime contractor level such a situation could lead to an erosion of MoD's ability to compete similar contracts in the future. Teams should consider whether the likely impact on long term VfM is large enough to justify the use of some other procurement approach, such as alliancing, to sustain the long term availability of essential industrial capability, subject to the usual value for money and affordability considerations. However, it is important that MoD does not sustain companies that would otherwise be unviable entities due to the legal and presentational issues involved.

Increasing the Opportunities for Competitive Procurement

25. Recognising the potential constraints imposed by strategic considerations and market structure, teams should look to use other opportunities to promote competitive pressure to ensure VfM is achieved.

26. The following should be considered when the procurement and commercial strategies are being developed:

a. *Review of the Defence Strategic Considerations.* Where competitive procurement is constrained due to defence strategic considerations, teams should review the nature and scope of the constraints to establish which are overriding and to consider the potential for trade offs.

b. *Licensing of IPR.* Where competitive procurement is constrained due to the lack of rights to utilise requisite IPR, then teams should consider whether licensing IPR is a viable option to enable competitive procurement.

c. *Encouraging Competition in the Supply Network.* Where it can be clearly demonstrated that security considerations and/or market structure prohibit the use of competitive procurement and a single source is selected, competitive procurement to deliver VfM should be encouraged throughout the supply network in line with the Codes of Best Practice 5 where this does not compromise UK national security and is both feasible and appropriate. Project teams must be aware there are specific rules for Subcontracting under the DSPCR 2011 to which they must adhere. The team should also demonstrate how the benefits from encouraged competition further down the supply network will feed through to the MoD.

d. *Reformulation of the Requirement.* Teams should consider whether the requirement could be reformulated or redefined to bring the competitive procurement process to bear.

e. *Stimulation of the Market.* It should be assessed whether the market could be stimulated to enable a competitive procurement to be held.

f. *International Collaboration*. International collaboration can deliver better value to the customer through the sharing of overheads and the benefits of economies of scale, encouraging the evolution of the global defence technological and industrial base.

g. *Co-operation with Other Government Departments (OGDs).*

h. Project teams should consider whether acting collectively with OGDs to meet competitive requirements will deliver better VfM compared to separate Departmental action.

i. *Security of Supply.* Project teams must consider at the start of the procurement the importance of an assured supply, in particular taking account of the criticality of the goods or services to Technology Advantage. The DSPCR allows procurers to take a number of non-discriminatory actions to protect Security of Supply. There are also a number of formal Security of Supply arrangements in place with other nations which can provide assurances to the UK in emergency situations.

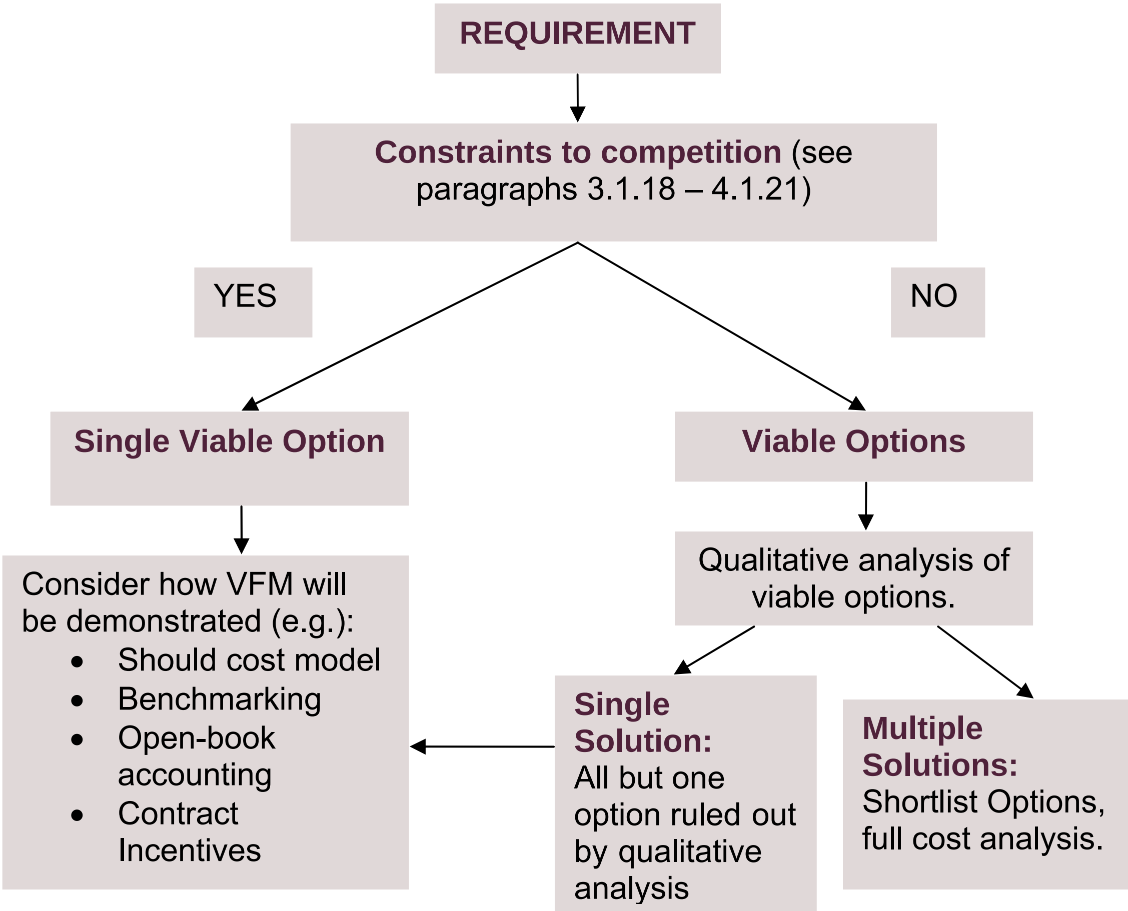
Assessment of Value for Money

27. Project teams should identify whether any constraints apply and, where they do, provide a full written explanation of their impact and the steps taken to maximise competitive procurement. Teams should not approach HM Treasury for consideration of their proposals until such work has been completed. All teams are required to provide evidence for the audit trail and obtain independent assurance from Defence Economics or the relevant TLB Appraisal and Evaluation team. An outline of evidence required is provided at Annex A.

Single Option Cases

28. Circumstances may arise in which an identified requirement can only be met by one option. An example of this may be where there is a requirement for the purchase from the Original Equipment Manufacturer of spares in support of a particular equipment. If there is no other supplier for the spares it can be a straightforward choice between buying and not buying. The same may also be true when purchasing repair/servicing, Post Design Services (PDS) or, where Intellectual Property Rights, Contractual Terms, or Design Authority status applies. Other examples could be where operational constraints limit the available options, or a long-term contract with options to renew or extend.

29. Options must not be limited by time or resource constraints due to poor planning or management decisions or by departmental strategies. **Agreement must be sought from Defence Economics or the relevant TLB Appraisal & Evaluation team in all such cases, and this does not remove the requirement to assess optimism bias, risk, and affordability**.



30. Where it has been assessed that only one viable option exists to meet a defined requirement, it will be necessary to determine that the cost of that option is not unreasonable. This will typically be achieved through the production of a ‘Should Cost’ model (see Part 2, Chapter 8, paragraph 11), cost comparator, or benchmark. A range of measures may be necessary to demonstrate value for money through life (see Part 2, chapter 8, paragraphs 41 - 51).

Routine Re-provisioning Decisions

31. Routine re-provisioning or renewal of contracts do not require an investment appraisal or value for money assessment providing the following criteria apply:

a. A requirement exists and has been established by an existing contract;

b. Value for money has been satisfactorily delivered, evidenced by evaluation (see Part 2, chapter 7);

c. There have been no changes in circumstance from the original procurement.

32. Evidence must be presented that consideration has been given to:

a. the remaining period the equipment is expected to remain in service;

b. the planned future utilisation of the main equipment and how this differs from past experience;

c. spares consumption or Mean Time Between Failure (MTBF) rates;

d. current levels of free stock;

e. stock return trends.

33. Where there are any other significant factors to be considered, such as potential alternative suppliers or innovative support packages, an appraisal must be undertaken.

Business Improvement Policy

34. The overriding objective is to provide defence outputs offering best value for money affordable to the taxpayer. As part of the process of ensuring a fair comparison can be made between the true costs and risks of undertaking activities commercially and those of retaining activities in-house an investment appraisal must be produced.

35. In reviewing activities, there is a need to:

a. set clear objectives;
b. ensure that the scope is fully defined and robust;
c. consider the full range of options to meet the requirement including in-house options;
d. undertake a fully detailed risk assessment;
e. achieve the best value for money outcome within available funding.

36. The scoping and feasibility stages of each review will determine the eventual means of securing improvement. In determining the appropriate scope, consideration should be given to the potential impact on MOD employees inside and outside the project boundary. Whatever the eventual outcome, the review process is likely to result in new ways of delivering services and TUs will need to be involved. Management must keep the TUs fully informed and consult with them as appropriate and at the appropriate level. The process must be as transparent as possible recognising commercial sensitivities, to ensure that Trade Unions and staff understand how an objective decision will be reached. It should be borne in mind that MOD policy for interaction with TU's is clearly set out in the Employee Relations Policy located in the People Services pages of the Defence Intranet and any failure to adhere to its direction is likely to delay, rather than expedite the project.

37. TLBs or Trading Funds considering proposals for the external provision of services will need to address the full resource implications of such projects. Potential projects must be given proper priority and be effectively managed. If the potential benefits from commercialisation appear to be relatively small, and are likely to be outweighed by the costs of competition or the increased MOD management costs, the work should be retained in-house.

38. Management must approach consultation with an open mind and seek to achieve agreement by creating a relationship with the Trade Unions based on mutual trust through openness, explanation and the exchange of views. Consultation is likely to involve informal

dialogue as well as the formal processes set out in the Employee Relations Policy section of People Services on the Defence Intranet.

39. An important part of the scoping work will be the agreement of the requirement. This should reflect the capability required, expressed in output terms. It will not necessarily equate to the scope of work that may be contracted to industry. The requirement will form the basis for developing options for the delivery of the required capability. In drawing up the requirement, management must engage the Trade Unions and the workforce as fully as possible at the earliest practicable stage.

Options

40. Once the scope of the work has been identified and the requirement has been agreed, the context of the review will determine the nature of the assessment. Where work is currently conducted in-house, TLBs and Trading Funds will need to ask:

a. Should some or all of the work be retained in-house, and if so how can efficiency improvements be made?
b. Where it is judged that best value for money could be achieved by commercialisation of some or all of the work currently conducted in-house, how should this be done?

41. Where work is currently provided under contract with the private sector, the issues are likely to be:

a. How is the existing contract performing?
b. Does the opportunity exist for de-scoping i.e. bringing some or all of the work back in-house, perhaps as part of a wider in-house efficiency initiative?
c. Where contracts must be re-competed, how best should this be done?

Value for Money Benchmark

42. Reviews of business activities will always need to establish the most cost-effective option for delivering that activity. Part of this examination will need to be an assessment of whether any in-house processes currently in place can be improved. Whenever a project includes an option for delivery of the requirement through a commercial bid, an appropriate Value for Money Benchmark (VfMB) must be developed.

43. The purpose of the VfMB is to test the value for money of commercial bids. It can take a number of different forms and may incorporate in-house provision, bought-in services, or a mixture of the two:

a. In the majority of cases the VfMB will be an assessment of the cost of how MOD would deliver the defined output as the best alternative to commercial bids (i.e. a 'would cost' model). It should not be constrained by affordability. The VfMB is likely to be based on existing methods of delivering the requirement, but should take into account all reasonably foreseeable efficiencies in delivering the defined output. Trade Unions should be consulted and invited to provide suggestions for possible efficiencies and new working practices. Every effort should be made to provide realistic and deliverable cost estimates. However, it would not be usual to seek firm prices from industry to inform the VfMB.

b. In larger or more complex cases, additional effort will be appropriate to establish an operationally achievable, fully deliverable, robust benchmark. Construction of a Fully-resourced VfMB requires the establishment of a dedicated team and budget to provide the necessary resource to fully develop ‘do better’ or ‘do different’ options. A Fully-resourced VfMB can add value to the competition process as it offers a challenging, deliverable solution. However, significant costs will be incurred, and the Department needs to be confident in advance of incurring such cost there is a reasonable prospect of its recovery; i.e. that this option can deliver a value for money solution.

c. A ‘Should cost’ model is an assessment of what a commercial solution to deliver the defined output should cost. This is appropriate where the activity is not currently provided, and could not be provided, in-house e.g. construction. The ‘should cost’ model is a theoretical construct of how the project team considers a commercial provider would deliver the requirement. The costs of each delivery element would be estimated from information gathered from existing sources (e.g. past contracts, CAAS pricing), and from relevant external sources (e.g. market soundings, sector consultants). It is not an achievable solution, but provides a target to inform contract negotiations with commercial bidders.

44. The appropriate form of VfMB to adopt must be agreed with and endorsed by Defence Economics, or the relevant TLB Appraisal and Evaluation team for projects within TLB thresholds. Trade Unions must be informed and consulted. Defence Economics is the final arbiter in the process.

Risk

45. To be a valid benchmark against which private sector bids can be compared fairly, the VfMB must reflect not only certain procurement costs but also the risk that additional costs may arise, which under industry proposals would fall to the supplier. During the procurement process, risks should be identified, and ways in which these risks can be mitigated considered. It is necessary to assess the impact of these risks on costs, estimate their probabilities, and explore and appreciate the sensitivity of these estimates. In many cases, adjustments to the original cost estimates will be needed to arrive at the final risk adjusted VfMB. Comprehensive accounting for risk is required to ensure that valid and informed comparisons can be made amongst the bids and between the bids and the VfMB.

In-House Efficiencies

46. There will be circumstances where the best course of action for the Department may be to continue to deliver activities in-house but to improve the efficiency of the existing business process. Reasons may include;

a. the activity is not suitable for commercial treatment (perhaps because it is too specialised or because business processes are too inextricably linked with tasks, which for military reasons must be kept in-house),

b. risk cannot be satisfactorily transferred to the private sector.

The onus is on the Department to pursue all possible means of improving the efficiency of activity delivery.

47. In examining the scope for more cost effective solutions, it is important that management and workforce alike should realise there should be no presumption that any previously successful In-House Bid (IHB) or VfMB should be maintained indefinitely. However, the Department is not required to compete work won previously by IHBs if, following rigorous investigation, they believe that commercialisation offers poor prospects of better value for money or the cost of conducting the tender exercise outweighs the benefits that might accrue from commercialisation. This would need to be revisited periodically to test that it remains valid. In such cases, it will be up to management to engage the Trade Unions and the workforce in order jointly to pursue all available means of improving and reducing the cost of that activity in-house.

48. The Department should examine the scope for efficiencies in undertaking activities in an innovative manner. For example, they might consider the potential scope for "bundling" similar activities to increase the potential for synergies or economies of scale to be realised. On the other hand, too large a span in bundling can result in over complication and unnecessary overheads. TLBs or Trading Funds will want to take into account experience elsewhere in the Department in deciding which activities can be delivered and provide better value for money. It is for MOD as informed customer to decide how best to meet its requirements, but the Trade Unions must be consulted fully at all times. The aim must be to ensure that a comprehensive range of options are considered at the outset and the optimum solution should be arrived at following assessment of all relevant factors such as their viability, economic appraisal and consistency with business plans.

Tender Evaluation

49. The Trade Unions must be invited to appoint an independent observer as part of the bid evaluation process, as set out in the Employee Relations Policy located in the People Services pages on the Defence Intranet.

Review of Existing Outsourced Contracts

50. Where activities are already provided by a commercial contractor, a review of all options should consider whether the services could be provided more cost effectively in the future. At contract expiry, the contract will normally be re-let following competition amongst external providers. It might be possible to undertake activities more effectively in-house through imaginative and innovative approaches rather than continue to pursue the commercial solution. In such circumstances the existing commercial operation, together with much of its working practices and corporate knowledge would be transferred in-house. TLBs and Trading Funds will need to clearly demonstrate at the outset that the introduction of competitive in-house proposals offer even better value for money (for example by building on the experience of the commercial sector) when compared with existing commercial arrangements. In such circumstances, a VfMB should be developed in consultation with the Trade Unions, and considered alongside other commercially-based options.

Extending Life of Existing Outsourced Contracts

51. The negotiation of an extension to a contract beyond its original performance, cost and time envelope will be the exception and not the rule and will require a clear business case. Extending an existing contract will usually be a short-term measure, and

must not be used to circumvent a competition for re-let. Value for money must be demonstrated and subjected to appropriate scrutiny in all such cases. Legal and Commercial Policy advice must be sought at an early stage to ensure that the MOD's obligations under the EU Services Directive and competition law are complied with and that the Department's industrial and competition policy is followed. Trade Unions must be informed and given the opportunity to be consulted.

External Assistance

52. External Assistance can be summarised as the procurement from the private sector of consultancy assistance. Cases seeking to procure External Assistance must include all the elements of an appraisal as set out in Part 1, Chapter 2. In addition, the following specific points apply:

a. Internal consultancy resources must be considered before External Assistance is engaged. Alternative options for meeting the specified requirement must therefore include the option of MOD internal resources, even if that would require re-prioritisation of other tasks.
b. Trade Unions must be consulted on all proposals to procure External Assistance, initially on an informal basis, which may lead to a formal consultation period where TUs believe it necessary.
c. Skills Transfer from the External Assistance provider to MOD staff is required unless it can be demonstrated not to be appropriate. The approach to ensure the transfer of skills must be set out.
d. Cases must comply with DCP-EF-03-08-01 dated 11 June 2010 'External Recruitment Freeze'.

53. Where there is a requirement to extend an existing contract, an evaluation must be undertaken to assess the performance of the contractor. As long as the criteria set out in paragraph 31 above apply, an investment appraisal is not required.

Disclosure of Financial Information to Industry

54. It is important that a disclosure strategy is drawn up before the project team engages with industry. Project teams planning to release financial information to industry should consult with Partnering Support Group (PSG) and Defence Economics, and provide documented approval from the Senior Responsible Owner (SRO) for the project. The documented disclosure strategy should be referred to in the Concept of Analysis and Initial Gate Business Case, or equivalents, Additional guidance is provided at Annex B.

55. The data shared with suppliers on particular programmes and projects will vary depending on the procurement strategy being followed, and individual circumstance. The underlying principle is to ensure disclosure is consistent with MOD securing the best value for money solution to the taxpayer. However, there is a need to protect information whose disclosure could harm security or international relations, undermine internal policy or prejudice MOD's position in negotiations with suppliers.

56. Where there is effective competition and adequate funding available, it is not usually necessary to release financial information as the competitive process will ensure value for money is delivered.

57. Where there is competition but the affordability of the requirement is in doubt, an indication of the overall funding allocation (affordability envelope) and, where relevant, the profile of that provision can be made. This may prevent nugatory activity from being undertaken, and the competitive process should ensure the data provided does not coincide with MOD's willingness to pay.

58. In a non-competitive environment the extent to which MOD may be prepared to disclose data must be judged on a case by case basis. Relevant guiding factors will include: the position of a project in its lifecycle; potential sensitivities of international partners when the project is a collaborative one; and the nature of the relationship already established with specific companies. Examples of information that may be disclosed include:

a. An indication of the overall funding allocation (affordability envelope) and, where relevant, the profile of that provision. This should only be considered where the affordability of the requirement is in doubt, and must not indicate MOD's willingness to pay.
b. 'As Is' or 'baseline' costs. This may help MOD and industry to gain a better understanding of the existing operation. It will also help to ensure a comprehensive and robust profile of the costs of the current arrangements is produced;
c. Details of technical efficiencies. Validation with industry will ensure both parties have confidence that costs are robust and the solutions are deliverable.
d. Known planning assumptions across the life of the project, e.g. known out of service dates.

59. Examples of information that would not normally be released include;

a. Relative price inflation, such as project specific earnings inflation. This is because it could become self-fulfilling.
b. Details of operational (non-technical) efficiencies applied to the VfMB. This would undermine the willingness of the Trade Unions to suggest such efficiencies or engage in the process.

60. Under no circumstances should the following information be released to industry, whether in a competitive or non-competitive environment:

a. Costed risk adjustments, in total, or by constituent parts;
b. Total VfMB figure inclusive of risk.

Fallback or Exit Strategy

61. There is no guarantee that the VfMB or the commercial bids will be affordable. Where the VfMB is unaffordable through-life, a modified version that is affordable needs to be developed, even if the resulting option provides lower capability. The affordable fallback option will be used to help demonstrate the relative benefits of the commercial bids.

62. Financial provision should be continually reviewed to check the affordability position of the options being developed, with regard to assumptions on e.g. balance sheet treatment, and the ability to flex between RDel and CDel.

63. Solutions that are affordable through-life may have short-term affordability shortfalls from one year to the next. Attempts to smooth short-term affordability peaks and

troughs with industry must take full consideration of the changes in risk profile this is likely to bring.

Tender Evaluation and Value for Money

64. Public contracts must be competed in accordance with Public Contracts Regulations 2006 (PCR) or Defence and Security Public Contracts Regulations 2011 (DSPCR) (the Regulations).

65. The Treaty on the Functioning of the European Union (TFEU) enshrines principles of proportionality, equal treatment, non-discrimination and transparency which the MOD must apply in relation to its contract award criteria. Application of these principles also needs to be consistent with the policy requirement to demonstrate value for money.

66. This guidance is complementary and supplementary to that contained within the Tendering Suite of Commercial Policy Statements (see www.aof.dii.r.mil.uk) addressing the key issues to ensure that commercial, legal and economic requirements are coherently addressed when establishing the criteria for tender evaluation.

Evaluation Strategy

67. The first decision to make is the appropriate evaluation strategy for the proposal, and this is then published in the Contract Notice. In accordance with Regulation 31 of DSPCR and Regulation 30 of PCR, the evaluation strategy can be based on either:

a. Lowest price (lowest cost). The contract will be awarded to the 'lowest price' tender that is technically and commercially compliant. This cannot be used if the Competitive Dialogue procedure is being followed.

or

b. Most Economically Advantageous Tender (MEAT). Using an evaluation based on MEAT provides the opportunity to take criteria other than price into account when awarding a contract. There are several MEAT evaluation strategies that can be adopted. These are set out in the Commercial Policy Statement on Tender Management.

Award Criteria

68. Award criteria are the criteria the tenders must meet and those that the tenders will be measured against. Where a MEAT evaluation strategy is used, appropriate, specific and relevant award criteria are scored and weighted to establish which tender is most economically advantageous. The criteria should be sufficiently transparent so that a bidder is aware of all the elements to be taken into account by MOD in identifying the most economically advantageous and the relative importance of those elements. 'Most economically advantageous' can be taken as being largely analogous to Value for Money (VfM), where VfM is defined as the optimal trade-off between time, cost, and effectiveness.

69. Award criteria are typically grouped into three categories: technical, commercial and financial. Deciding on the technical and commercial criteria to include is a matter of judgement and will vary from project to project, but each needs to represent a specific and measurable objective. In seeking to establish fundamental end objectives it is useful to:

a. Repeatedly ask the question ‘Why do you care about that?’;
b. Ask how the options differ from one another in ways that matter;
c. Ask about the overall objectives that are to be achieved.

The award criteria must relate to the goods or services to be provided and not to the suitability of the supplier.

70. Note that choosing award criteria is a separate process to that of selection criteria used to assess whether a **potential bidder** is capable of meeting the requirement. Initially, this is done on the basis of economic/financial standing or technical/professional ability, but an additional down-select may be exercised by applying other objective and non-discriminatory criteria. Essentially, it is to determine which potential bidders will be invited to participate in dialogue, negotiation, or tender.

71. Guidance on the selection, scoring and weighting of award criteria and the evaluation methodology is caontained in Part2, chapter 8.

Publication of criteria

72. The award criteria must be discussed with, and endorsed by Defence Economics and D Scrutiny or their TLB equivalents in addition to commercial and legal staff to ensure that the criteria and weightings for tender evaluation are consistent with achieving value for money. The award criteria and their weightings should ideally be endorsed before the issue of the Contract Notice (OJEU advert) and must be endorsed and included in the Tender Documentation before an Invitation to Participate in Dialogue (ITPD), Invitation to Negotiate (ITN), or Invitation to Tender (ITT) is issued. Early engagement with scrutiny staff is therefore essential.

Wider Markets Initiative

73. The Wider Markets Initiative (WMI) encourages the public sector to adopt a more entrepreneurial approach to making the most effective and efficient use of public assets, by using capacity which is surplus to normal requirements, but which must for wider strategic or other reasons be retained within the public sector, to generate income. This generally involves marketing the assets to private individuals or companies for revenue, which can then be used to fund activities within the public sector. Holders of assets can run Wider Markets projects themselves; or they may choose to engage a private sector partner.

74. Policy on wider markets is set out in "Selling into Wider Markets: A Policy Note for Public Bodies" HM Treasury 2002

(http://www.hm-treasury.gov.uk/media/ED8AB/New_WM_Guidance.pdf)

75. When seeking to exploit irreducible spare capacity under this initiative, regulations covering partnering and outsourcing apply in the normal way. Consideration must be given to the following issues:

a. Treatment of fixed assets;
b. Allowance for additional costs to achieve third party income;
c. Need to appraise WMI against alternatives such as PFI.

Private Finance Initiative

76. Policy and guidance for assessing value for money in relation to the Private Finance Initiative (PFI) is located on the MOD PFU teamsite on the Defence Intranet, and is not considered further in this JSP.

Annex A: Demonstrating the Policy - Providing Evidence for the Audit Trail

The following questions should be considered simultaneously when providing evidence for the audit trail.

1. Circumstances where Defence Strategic Constraints apply to the requirement.

Defence Strategic Considerations

- Why do Defence Strategic Considerations apply to the requirement?
- Can these be relaxed?
- Are they tradeable?
- Can a Security of Supply arrangement be used where appropriate?

Market Constraints

- Is there a competitive market? **If yes, use a competitive procurement approach**.
- Can the market be stimulated through market sounding, promoting the requirement beyond the market segment from which it is usually procured, aggregating requirements or breaking requirements down? **If yes, use a competitive procurement approach.**
- Can the requirement be reformulated to enable competitive procurement e.g. breaking the requirement down to allow a single source to deliver the protected element (subject to the Defence Strategic Considerations) whilst other elements are procured through competition? **If yes, use a competitive procurement and a sole source approach for the protected element.**
- Does the MOD have access to IPR to enable competitive procurement? **If yes, use a competitive procurement approach and a sole source approach for the protected element.**
- Can the IPR be licensed? **If yes, use a competitive procurement approach through licensing the IPR**.
- Where a non-competitive procurement approach is justified, can competition be encouraged in the supply network?

2. Circumstances where Defence Strategic Considerations do not apply to the requirement

- Is there a competitive market? **If yes, use a competitive procurement approach**.
- Can the market be stimulated through market sounding, promoting the requirement beyond the market segment from which it is usually procured, aggregating requirements or breaking requirements down? **If yes, use a competitive procurement approach.**
- Can the requirement be reformulated to enable competitive procurement e.g. breaking the requirement or aggregating requirements to stimulate industry's interest? **If yes, use a competitive procurement approach.**
- Does the MOD have access to IPR to enable competitive procurement? **If yes, use a competitive procurement approach.**
- Can the IPR be licensed? **If yes, use a competitive procurement approach through licensing the IPR**.

- Can the protected element (subject to IPR restrictions) be procured through a single source arrangement whilst other elements are procured through competition? **If yes, use a competitive procurement approach and sole source for the protected element.**
- Where a non-competitive procurement approach is justified, demonstrate how competition be encouraged in the supply network.

Annex B: Disclosure of Financial Information to Industry

When considering releasing financial information to industry, the key questions that must be addressed are:

a. **Why** is it necessary or beneficial to release information?
b. **What** information is it appropriate to release?
c. **When** is the appropriate time to release information?

The answers to these questions may be different for each individual project, and Project Team Leaders must decide what is right for their project. **The aim will always be to achieve a better deal for MOD without compromising its negotiating position and securing best VfM to the taxpayer.**

The Project Team Leader is accountable for the scale of the cost information released, and is required to demonstrate that its release is appropriate in order to optimise the potential for a value for money outcome. A record of the rationale applied must be incorporated into the Disclosure Strategy documentation, and addressed as part of the evaluation process for the project.

Key factors to be considered

The release of financial information should only occur after the consideration of all relevant factors by the Project Team. The following provides a summary of the key factors:

- The assessment of the relative strength and practicability of effective competition.
- Is it necessary to release cost information or will the underlying assumptions be sufficient?
- A judgement on the potential added value likely to be gained by the project in terms of cost, time and performance
- What other non-financial information is being disclosed? Is it compatible with the cost disclosure information?
- What outcome is required as a result of disclosure?
- Is disclosure likely to weaken MOD's negotiating position?

Benefits

There are benefits from disclosure of information to industry in certain circumstances:

- A full understanding on how business is currently conducted.
- An awareness of the Authority's future requirements.
- Identification of the key cost drivers and where efficiency gains may be possible.
- Validation of technical efficiencies that could be incorporated into the VfMB in order that all parties have confidence the costs are robust and the solutions are deliverable.
- An opportunity to understand the business processes, in particular, where transfer of risk benefits and business re-engineering can be made to best effect.
- Improve understanding of the capability deliverable from the funding available.

- Provides an indicative target for industry to aim at.
- The identification and understanding of risk.
- Prevents nugatory activity when affordability is severely constrained.

Risks

The risks associated with disclosure of information to industry include:

- Bidders may be inclined to bid just below the indicative target figure provided. This can be mitigated by emphasising that meeting the target is unlikely to be sufficient to secure the deal. Value for money does not necessarily mean selecting the cheapest option.
- Loss of negotiating leverage. This should not be affected if negotiations are pursued following extant commercial guidance.
- The unnecessary transfer of intellectual capital.