Cabinet Office

CO (10) 2

Circular

1 August 2010

Intended for

All Ministers
All Chief Executives
Speaker of the House
General Manager, Parliamentary Service
Controller and Auditor-General
All Senior Private Secretaries
All Private Secretaries

Capital Asset Management in Departments and Crown Entities: Expectations

Introduction

1 This circular sets out Cabinet's expectations for the approval of, and assurances relating to, major capital projects, and for the management of plant, property, equipment, and software resources used in the delivery of government services by public service and non-public service departments ("departments") and Crown entities, especially Crown agents.[1]

2 This circular is in four sections:

2.1 Section A outlines Cabinet's role and interest in major capital decisions;

2.2 Section B sets out expectations relating to the quality and timing of capital proposals and associated business cases;

2.3 Section C sets out assurance and monitoring expectations;

2.4 Section D sets out expectations relating to asset management and reporting.

3 The changes introduced in this circular will not apply retrospectively (i.e. the expectations will not apply in cases where final decisions have been made under previous authorities). The circular will apply, however, to all new variations on existing projects for the purchase or development of departmental fixed assets, and to all changes or additions to existing fixed assets and operating leases for fixed assets.

4 In this circular, references to financial thresholds for individual proposals are expressed in whole of life cost terms (WOLC). Annex 1 provides an explanation of WOLC. All financial thresholds used in this circular are GST exclusive.

[1] This circular replaces Cabinet Office Circular CO (01) 4, entitled *Monitoring Regime for Major Information Technology (IT) Projects*, and the capital expenditure aspects of CO (99) 7, entitled *Financial Delegations and Delegation Limits for Responsible Ministers and Departmental Chief Executives.* CO (09) 6, entitled *Guidelines for Changes to Baselines*, replaced the remainder of CO (99) 7.

5 Further guidance may be provided in Treasury Circulars for particular events, such as the Budget process or the reporting of long-term capital intentions.[2]

6 Ministers and chief executives are asked to ensure that all staff handling submissions for Cabinet, Cabinet committees and baseline updates are familiar with this circular, and that the material in this circular is conveyed to all departments, Crown agents, and other Crown entities.

Section A: Cabinet's role and interest in major capital decisions

Approval thresholds

7 Cabinet will continue to make decisions on all departmental or non-departmental capital expenditure and lease proposals where new Crown funding is required.

8 Cabinet must have an appropriate and early opportunity to engage with all Public-Private Partnership-type (PPP) procurement transactions proposed by any department or Crown agent, as these can have significant fiscal and policy implications and can affect the government's reputation in the commercial marketplace.

9 Proposals relating to the following types of large or risky transactions require *Cabinet* approval:

Table 1: Capital expenditure, lease and asset disposal proposals that require Cabinet approval

Type/owner of proposal	All departments[3]	Crown agents	Other Crown entities
All proposals that require new Crown funding	✓	✓	✓
All PPP proposals, even if funded from baselines and balance sheets	✓	✓	
All departmental capital expenditure or lease proposals with a WOLC over $25 million, even if funded from baselines and balance sheets	✓		
All proposals to dispose of assets held on the Crown account that have significant policy implications[4]	✓	✓	✓
All proposals to dispose of departmental assets with a carrying value of $25 million or more	✓		
All high risk[5] departmental capital expenditure or lease proposals, irrespective of the scale and funding source	✓		

[2] These can be found under "Circulars" on the Treasury's CFISnet website or the main Treasury website.
[3] I.e. public service departments and non-public service departments.
[4] Consistent with CO (09) 6, a significant policy issue is any noticeable change in the price, quantity or standard of what is purchased through the appropriation. The general rule for whether a proposal should go to Cabinet is set out in paragraph 5.11 of the *Cabinet Manual*.
5 The proposal or project risk profile is determined by the State Services Commission's (SSC) Gateway Unit based on the Gateway risk profiling methodology.

10 Proposals relating to the following types of transactions may be approved by the *responsible Minister*:

Table 2: Capital proposals that require approval of the responsible Minister		
Type/owner of proposal	**All Department**	**Crown agents and other Crown entities**
All departmental capital expenditure and lease proposals with a WOLC of between $15 million and $25 million, if funded from baselines and balance sheets	✓	
All proposals to dispose of departmental assets with a carrying value of between $15 million and $25 million	✓	
All proposals to dispose of assets held on the Crown account that have non-significant policy implications	✓	✓

11 Proposals relating to the following types of transactions may be approved by the *departmental chief executive*:

Table 3: Capital proposals that require approval of the departmental chief executive
All departmental capital expenditure and lease proposals with a WOLC of up to $15 million, if funded from baselines and balance sheets
All departmental asset disposals with a fair value of up to $15 million

12 Annex 2 sets out further operational expectations in relation to the capital approvals regime.

Section B: Expectations relating to quality and timing of proposals and associated business cases

General expectations

13 General baseline management expectations relating to proposals that require new funding are set out in CO (09) 6, entitled *Guidelines for Changes to Baselines*. The annual Budget process is Cabinet's primary vehicle for considering how best to allocate capital and operating resources. The more significant any proposed change to baselines, the stronger the case that the proposal should be considered as part of the Budget process.

14 Cabinet should be engaged, as early as practicable, in key capital decision-making processes. For that to occur, Cabinet needs high quality information at the right time to help it make the decisions characterised in Table 1 above, and to assess the impacts of those decisions over time.

15 All proposals requiring Cabinet approval must be developed in accordance with published Treasury business case guidance, which will be updated from time to time. The Treasury's business case guidance enables departments, Crown agents and monitoring agencies to:

15.1 apply consistently a proven set of processes and analysis;

15.2 ensure that proposals going to Cabinet meet the appropriate quality standard;

15.3 ensure that Cabinet has visibility of large or high risk proposals at key project milestones.

Specific expectations

16 All proposals requiring Cabinet approval must reveal the strategic, economic, financial, commercial, and management rationale for the proposed capital or lease expenditure, or asset disposal.

17 All proposals requiring Cabinet approval that are determined by the SSC Gateway Unit to be high risk must include the results of a quantitative risk analysis in the business case to assist Cabinet to make decisions on the level of any appropriations, access to cash draw-downs, access to contingency funding, and to focus attention on key project assumptions, sensitivities and risks.

18 All proposals requiring Cabinet approval that have a WOLC in excess of $25 million must include in the business case an evaluation of alternative procurement options, including a PPP.

19 All departments and Crown agents must consult with the Treasury's National Infrastructure Unit (NIU) early in the development of a PPP-type procurement proposal, and must give the NIU the opportunity to make a representative available to relevant PPP project steering and working groups. The NIU must be involved in the economic and financial assessment and advice on all PPPs.

20 Departmental chief executives must adopt and apply the Treasury business case guidance to all capital proposals that need the approval of the responsible Minister. Even where the approval of Cabinet or the responsible Minister is not required, there is an expectation that Treasury business case guidance will be adopted.

21 Internal departmental processes and capabilities should be able to generate business cases of the right quality and at the right time, risk, and scale of the proposal, consistent with the published Treasury business case guidance for the type of decision sought, risk, and scale of the proposal.

22 Responsible Ministers will invite chief executives and boards of Crown agents to adopt and apply the Treasury business case guidance to all capital proposals. There is an expectation that Treasury business case standards will be adopted as good practice and applied to internal management processes in Crown entities.

Two-stage Cabinet approval process for large or high risk proposals

23 Unless otherwise agreed by the monitoring department and the Treasury, a two-stage approval process must be followed for all capital proposals that require Cabinet approval as outlined in Table 1 above. The two stage process consists of:

23.1 **Stage 1**: Consideration of the *indicative business case*, which confirms the case for change and the need for investment, considers possible options, recommends an indicative or preferred way forward for further development of the proposal, and seeks the early approval of decision-makers to further develop the investment proposal;

23.2 **Stage 2**: Consideration of the *detailed business case*, which sets out the basis for a recommended course of action that maximises value for money, and seeks approval to develop and finalise the arrangements for successful implementation. Approval at this stage may be given subject to certain constraints or conditions.

Additional requirements for proposals that are both large scale and high risk

24 Unless otherwise agreed by Cabinet, chief executives of departments and Crown agents that seek Cabinet approval for proposals that are both large (i.e. over $25 million WOLC) and high risk (as determined by the SSC Gateway Unit), must:

24.1 provide a "commissioner's statement" which represents a formal statement by the relevant chief executive to Cabinet (via the Crown agent's board where applicable) that the business case on which the proposal is based is sound, has examined relevant procurement options, and is deliverable and affordable taking account of whole life costs, current baselines, and balance sheets;

24.2 report to Cabinet (via the Crown agent's board where applicable) within 12 months after the in-service date of the Cabinet-approved proposal on the actual level of benefits achieved compared with those outlined in the Cabinet-approved proposal.

Single stage Cabinet approval process permitted in some cases

25 A single stage approval process is permitted for proposals which seek new Crown funding that are both small scale and low risk (as determined by the SSC Gateway Unit). Consistent with CO (09) 6, such proposals should be considered in the annual government Budget process.

Section C: Assurance and monitoring expectations

Gateway assurance

26 Gateway is a multi-gate project and programme assurance regime designed to provide confidential, independent, high-level, action-oriented recommendations to project sponsors at key project milestones, focusing on the issues that are important to the continuing success of the project.

27 The Gateway regime, operated by the SSC Gateway Unit, applies to all high risk capital programmes or projects of departments and Crown agents, irrespective of the size of the project or the funding source.

28 The final risk profile (i.e. whether high or not high risk) will be determined by the SSC Gateway Unit based on its assessment of an initial Risk Profile Assessment (RPA) provided by the relevant agency, and other factors. The responsible Minister may also request that a project be deemed to be "high risk" and therefore be subject to the Gateway Review regime.

29 Departments must, and Crown agents are expected to, perform an initial RPA for all projects that would expose the government to significant fiscal or ownership risks if it were not delivered within the projected functionality, cost, and timelines.

30 Those agencies must then disclose to the SSC Gateway Unit the RPA results for any projects with either a medium or high risk profile. Agencies must contact the Gateway Unit as early as possible to ensure that high risk projects receive the full set of Gateway reviews.

31 The RPA provides information that underpins the expectations in this circular. Accordingly, failure by a department or Crown agent properly to perform and disclose the results of an initial RPA, or to submit timely requests for applicable Gateway reviews, is a serious matter, and will be viewed negatively.

32 The SSC Gateway Unit will, at the discretion of the State Services Commissioner, recover some or all of the costs of running the Gateway regime from departments and Crown agents that receive Gateway reviews.

Monitoring high risk projects

33 Monitoring activity is designed to provide independent advice to responsible Ministers on the likelihood of certain projects delivering expected benefits in the required timeframe, at the required quality and within fiscal, policy, or operational constraints.

34 Central agencies will monitor all departmental projects that are determined as high risk by the SSC Gateway Unit or where otherwise requested to do so by the responsible Minister, whether the project is ICT-enabled or otherwise and however funded.

35 Central agencies will:

35.1 publish guidelines on project monitoring and project management disciplines;

35.2 apply a consistent set of judgements for the purposes of determining whether a particular project is to be subject to Gateway review and/or project monitoring;

35.3 foster the widespread use of the project monitoring guidelines and recognised project management disciplines in Crown agents and throughout the rest of the State sector.

36 Departmental chief executives must adopt and apply the central agency guidance on project monitoring and project management to all capital proposals that need the approval of the Cabinet or the responsible Minister. Even where the approval of Cabinet or the responsible Minister is not required, there is an expectation that central agency guidance will be adopted.

37 Responsible Ministers will ensure that their monitoring departments apply the same quality of major project monitoring practice to high risk projects undertaken by Crown agents as central agencies apply to high risk projects undertaken by departments.

38 Central agencies may re-charge departments (or Crown agents as appropriate) for any external Independent Quality Assurance commissioned by them for off-track projects.

39 Annex 3 sets out further information on the monitoring of high risk projects.

Section D: Asset management and reporting expectations

Asset management practices and performance

40 Sound management practices reduce fiscal and service delivery risks, and improve Ministerial confidence in departmental performance.

41 All departments and Crown entities are expected to manage their infrastructure assets effectively over the whole of their expected lifespan, recognising that making better use of existing infrastructure is as important as investing in the right mix of new assets.

42 From time to time Cabinet determines that certain departments and Crown agents are capital-intensive for the purposes of the CAM expectations. The current list of capital intensive agencies can be found on the Treasury website. Expectations about the quality of asset management practices are highest for capital-intensive departments and Crown agents.

43 Capital-intensive agencies must demonstrate a level of asset management practice and performance that is appropriate to the scale of assets under their management and the criticality of those assets to the delivery of key public services. Responsible Ministers should convey this expectation to the Boards of capital-intensive Crown agents.

44 Individual capital-intensive agencies will determine the appropriate level of asset management practices in consultation with the Treasury and the relevant monitoring department, and based on a Treasury-endorsed asset management maturity matrix.

45 The Treasury will periodically commission an independent assessment of asset management practices in capital-intensive agencies (made with reference to a Treasury-endorsed asset management maturity matrix) and report to Cabinet on the results of such assessments.

Capital-intentions reporting

46 Cabinet requires information on agency capital-intentions to inform decisions on fiscal policy settings and the affordability of current policies and future service delivery strategies.

47 Capital-intensive agencies will report to the Treasury annually on their long-term (i.e. ten years or more) capital-intentions. This reporting should cover major projects and major capital proposals, the current and projected performance of asset portfolios, and strategic choices for delivering cost-effective services.

48 The quality of long term capital-intentions information provided to the Treasury should be consistent with that used in the preparation of forecast financial statements.

49 The Treasury will report annually to Cabinet on the aggregate capital-intentions to inform government Budget and planning processes.

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Secretary of the Cabinet

Enquiries:
For further advice or information on fiscal management, please contact the relevant Treasury Vote Team. Information on financial recommendations can be found on the Treasury website at http://www.treasury.govt.nz. Guidance on PPPs and asset management can be found on the National Infrastructure Unit website at http://www.infrastructure.govt.nz/

For advice on Cabinet procedures, please contact the Cabinet Office. Information on writing Cabinet papers can be found on the CabGuide website at http://cabguide.cabinetoffice.govt.nz/.

Website reference:
This circular can be found on the internet at http://www.dpmc.govt.nz/cabinet/circulars/index.html.

Annex 1: Whole of Life Costs (WOLC)

1 The WOLC is defined as:

> *The Net Present Value (NPV) of cash costs of the proposal under consideration.*
>
> *Cash costs include the initial capital or operating costs, plus cash operating costs for the expected life of the asset, discounted using the Public Sector Discount Rate.*[6] *Operating costs may include costs of operational personnel if this is an essential part of the proposal.*
>
> *For Crown-funded proposals, the WOLC does not include depreciation expenses or capital charges.*

2 This definition takes account the time, value for money, and scale of the substantive proposal, not just the asset-related costs, consistent with the economic analysis required in the Treasury business case guidance.

3 Cash costs represent the costs incurred, on an ongoing and/or periodic basis over the period to enable an asset to be maintained to the same standard as that achieved on its construction, refurbishment, and/or procurement. The period varies according to the nature of the proposal, but for practical purposes may be considered to be the lower of the expected economic life of the asset or 20 years.

4 Operating Expenditure will include that required to ensure that an asset remains fit for its intended purpose over its expected life (maintenance and ancillary services, such as energy and cleaning, as well as overheads and insurance), plus any anticipated disposal or transaction costs.

5 The inclusion of non-asset operating costs in the WOLC measure (e.g. operational staff costs) depends on the nature of the investment decision:

5.1 if the investment is about expanding service delivery or changing the level of service, staff costs should be taken into account in the total cash cost associated with the investment decision;

5.2 if the investment is largely about replacing existing infrastructure with no impact on staffing costs, the WOLC should include only the asset-related costs.

6 Examples include:

6.1 a department with a software licence contract proposal estimated to cost $10 million (initial cost) and 20 per cent per annum in maintenance costs for nine years has a nominal cost of $28 million and a NPV of $22 million. This means that the responsible Minister has authority to approve the investment as it falls in the range of $15 million to $25 million WOLC;

6.2 a department has a building refurbishment proposal estimated to cost $50 million (initial cost), with two $5 million refits over 20 years and annual maintenance of two per cent, has a nominal cost of $80 million and a NPV of $65 million. At this level, Cabinet approval is required.

[6] The Public Sector Discount Rate is published by the Treasury.

Annex 2: Operation of the Capital Approvals Regime

Departments

1 Proposals outlined in Tables 1 and 2 above should be referred to the responsible Minister or to Cabinet for approval. The approval limits set out in this circular will apply to all departments, unless Cabinet approves a specific authority policy for that department.

2 A departmental chief executive's authority to incur expenses and capital expenditure applies to departmental appropriations only, as noted in CO (09) 6. That circular also notes the authority of the departmental chief executive to delegate.

3 Where a departmental chief executive has received a specific authority from Cabinet that differs from that set out in Table 3 above, the specific authority will continue to apply. Cabinet can also authorise a responsible Minister to negotiate changes to a departmental chief executive's financial authority within whatever parameters Cabinet considers appropriate.

4 Where a department proposes to incur expenses or liabilities in foreign currency, all applications for Ministerial or Cabinet authorisation must include a full statement of the currencies and amounts involved. All conversions of proposed expenses or liabilities to New Zealand dollars should be made at the relevant forward exchange rate (if forward cover has been taken) or at the conversion rate current at the time of application.

5 No financial commitments or expenses are to be incurred, projects commenced, settlements offered, or orders placed unless authority exists, or has been specifically authorised by the responsible Minister or Cabinet, consistent with the requirements of this circular.

6 Where Cabinet authorisation is required, a paper should be prepared in accordance with the CabGuide. The Minister of Finance should be consulted. Departments may apply for authority to commit at the same time as they request any change to appropriations or departmental baselines that might be required. For reasons of risk or uncertainty, however, Cabinet will not necessarily grant authority to commit at the time that an appropriation or baseline change is approved.

7 Departmental chief executives must seek an additional authority promptly when it becomes clear that an approved authority is likely to be exceeded. An additional or revised authority should also be sought where there is a proposed change to the scope of the work compared with what had previously been represented to, or agreed by, Cabinet or the responsible Minister.

Crown entities

8 Crown entity proposals outlined in Tables 1 and 2 above should be referred to the responsible Minister or to Cabinet for approval.

9 To the extent it applies to Crown entities, responsible Ministers should convey this policy to Crown entities for which they are responsible, through letters of expectation or similar instruments.

Annex 3: Monitoring High Risk Projects

1 In relation to high risk departmental projects, the central agency monitoring role involves:

1.1 providing advice to responsible Ministers on the merits of particular departmental business cases that require Cabinet approval;

1.2 reporting regularly to responsible Ministers on the status of high risk projects, and on any material adverse developments that could affect the department's ability to deliver the project benefits in the required timeframe, at the required quality and within fiscal, policy, or operational constraints.

2 The chief executive of the department responsible for a high risk project is accountable for:

2.1 meeting Cabinet expectations for the quality and timing of business cases, and for project monitoring and project management;

2.2 procuring independent quality assurance (IQA) on the project development process, and key issues and risks arising from the project. Terms of reference for IQA should be agreed with central agencies before the IQA activity commences;

2.3 forwarding copies of IQA reports, and their responses to any IQA recommendations, to the central agencies for monitoring purposes;

2.4 delivering the project and associated benefits, as outlined in the business case;

2.5 reporting to the monitoring agencies on any significant change to the scope, governance, or functionality relative to the approved business case;

2.6 ensuring that processes are put in place to manage off-track projects, if this becomes necessary.

3 Central agencies will jointly determine the nature of the monitoring activity to apply to high risk departmental projects.

4 Departments must re-assess programmes/projects previously assessed as not high risk, if there is a significant change to them that would affect the risk profile, and disclose to the State Services Commission's Gateway Unit any such projects where the re-assessment shows a medium or high risk profile.