

# **ASSESSMENT REPORT**

## **Value for Money Methodology in PPP projects**

Prepared as part of the Twinning Project CZ/2005/IB/FI/04



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### Appendices and references:

*Appendix A:* Public Private Comparator guidance, Ministry of Finance, the Netherlands, August 2002

*Appendix B:* Public Sector Comparator guidance, Ministry of Finance, the Netherlands, August 2002

*Web-link to:* Value for Money Assessment Guidance, HM Treasury, November 2006:  
[http://www.hm-treasury.gov.uk/media/4/4/vfm\\_assessmentguidance061006opt.pdf](http://www.hm-treasury.gov.uk/media/4/4/vfm_assessmentguidance061006opt.pdf)



**Legend of abbreviations:**

EU	European Union
MoF	Ministry of Finance of the Czech Republic
MoJ	Ministry of Justice of the Czech Republic
MS	Member State (the Netherlands and / or the United Kingdom)
MS STE	Member State Short Term Expert
OBC	Outline Business Case
PPC	Public Private Comparator
PPP	Public Private Partnership
PSC	Public Sector Comparator
PUK	Partnerships UK
RTA	Resident Twinning Adviser
STE	Short-term expert
UK	The United Kingdom
VfM	Value for Money



## 1. Introduction

This inception report has been prepared for the Ministry of Finance (MoF) in the Czech Republic. It has been developed with the assistance of Partnerships UK in the United Kingdom and the Public Private Partnerships (PPP) Unit at the Ministry of Finance in the Netherlands, under the auspices of the EU Twinning Initiative<sup>1</sup>. Whilst there are 7 components to this initiative, each covering a different PPP related element this paper relates solely to Component 1: Value for money (VfM) assessment of PPP projects.

The purpose of the inception report is to highlight a number of issues arising from the current approach to VfM assessment in the Czech Republic, and provide a preliminary indication of measures which could be considered for the development and effective implementation of appropriate VfM guidance. This paper should serve as a platform for the development of Czech specific VfM guidance. It is anticipated that the Twinning VfM experts will provide periodic support at key stages of its development and implementation.

In terms of content, the document includes a set of observations and recommendations further to a series of interviews arranged under the Twinning Initiative. These were attended by VfM experts (STE) from Partnerships UK<sup>2</sup> and the Department for PPP and Asset Management at the Dutch Ministry of Finance<sup>3</sup>, and coordinated by the Resident Twinning Adviser (RTA)<sup>4</sup>. The interviews were held with representatives from the Ministry of Justice<sup>5</sup>, the MoF<sup>6</sup> and the PPP Centrum<sup>7</sup> in Prague on December 16<sup>th</sup> 2006.

An overview of best Member State VfM practice is attached to the report by means of three annexes. The annexes contain guidance, which approach and content might assist the Czech authorities to further develop a VfM methodology.

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<sup>1</sup> This initiative was instigated on 4<sup>th</sup> October 2006. Its principal purpose is to facilitate the provision of support to the Czech Government from PPP centres of excellence in various EU Member States. The initiative is designed to assist the Czech Government with developing appropriate Czech specific PPP guidance based on best practice procedures; and help support its implementation.

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## 2. The Value for Money concept

### Value for Money concept

Governments have finite resources. It is therefore important that those making investment decisions in the public sector demonstrate that their decision represents value for money (VfM) for the public purse.

VfM can be divided into three components:-

1. *Efficiency* – organizing inputs to do the right thing
2. *Effectiveness* – organizing inputs so that the right outputs are achieved
3. *Economy* – obtaining the right inputs at the right price]

The use of PPP to procure key infrastructure projects in the delivery of essential public services often brings into sharper focus the need for appropriate VfM assessment in terms of selecting the most appropriate procurement route. VfM can be demonstrated in a wide variety of ways. The approach usually involves the use of some form of public sector comparator (PSC), reflecting the cost and benefits of conventional (public sector) procurement, as part of the VfM assessment and procurement route decision-making process. PSCs are however theoretical comparators. If used as the sole evaluation criteria, unrealistic PSCs can have an insidious effect, undermining sound project appraisal. Therefore usage of a PSC to assess VfM may often be supported by additional measures, including:-

- Assessment of competition (most compelling evidence that VfM is achieved is normally when a large number of firms compete intensely for a contract)
- Use of empirical evidence to generate benchmarks
- Benefits are assessed at the broadest level

### 2.1 Definition of the Value for Money concept

. VfM is the optimum combination of whole-of-life costs and quality (or fitness for purpose) of the good or service to meet the user's requirements<sup>8</sup> VfM methodology refers to the assessment and decision making processes on procurement routes applicable to public investment projects.

### 2.2 Use of the VfM concept in a PPP context

Public authorities act on behalf, and in the interests, of its citizens. The operational cost of the public administration and the cost of the services to be provided tend to be funded primarily by various forms of taxation.. Public authorities therefore need to demonstrate that they are deploying public funds in the most efficient and effective way (i.e. providing value for money) to obtain maximum social benefits. As the cost of major investment projects can be substantial in terms of required resources over the medium to long term, government policy may therefore require a thorough assessment of the various potential delivery options.

One way of procuring public service delivery is through the use of Public Private Partnerships (PPP). By examining the optimum balance of whole-life costs and quality, better decisions can be made with regard to the appropriate form of procurement which may involve a form of PPP or a form of conventional procurement to achieve this.

A VfM methodology can facilitate public authorities carrying out an objective and transparent decision making process. The VfM approach comprises identification of key-drivers for benefits / costs of potential procurement options (usually some form of conventional

<sup>8</sup> Source: Value for Money Assessment Guide, HM Treasury, UK, November 2006



procurement versus PPP) in both a qualitative and quantitative process. In the quantitative assessment, the costs and benefits of the conventional and PPP approaches can be analysed in terms of net present value. The cash flows of the conventionally procured option, known as a Public Sector Comparator (PSC) is used as a benchmark against which the costs of the PPP alternative can be judged. The VfM-methodology therefore promotes obtaining an insight in the whole-of-life costs of the project and the quality (or fitness for purpose) of the good or service to meet the user's requirements which leads to a better informed decision. However, it must be stated that the quality of the outcome of a VfM assessment is highly dependent on the quality of inputs to the analysis and is vulnerable to manipulation. Balancing the quantitative with a qualitative assessment can help address this.

A VfM analysis may be conducted at three levels during the development of a project and should be seen as a continuous process right through to service delivery. This approach helps to ensure that the assessment takes place at the earliest stage possible. For information purposes, the following is based on some relevant parts of the UK HM Treasury VfM Assessment guide (November 2006)<sup>9</sup>.

### Stage 1: Programme Level Assessment

Where a portfolio of potential projects is being considered, the aim of Stage 1 is to provide a clear strategic direction, whilst indicating where there may be a need, later in the process, for flexibility in the chosen procurement route for some projects. Programmes must take account of the fact that a percentage of projects are likely to switch procurement routes at Stage 2, and a very small minority of projects at Stage 3 where there is, for example, market failure.

#### Objectives of Stage 1:

- Provide an early assessment of whether PPP is likely to provide VfM for a programme of investment in public services, and an indication of the suitability for individual projects within the programme;
- Increase transparency and improve deal flow;
- Assist ministries as a whole, during the spending review process, in deciding:
  - allocations between capital and revenue budgets;
  - the volume and scale of work programmes to be supported, given the amount of capital and revenue funding available; and
  - the affordability of investments i.e. estimating the cost envelope for programmes; and
- Ensure ministries and procuring authorities have in place the necessary framework (both in terms of structure, skills, and capacity) to implement a PPP programme in a manner which ensures optimal VfM and minimizes transaction costs for both the public and private sectors.

The outcome of the appraisal should be to have a more robust understanding of the suitability of PPP for a specific programme of projects, and also to ensure a closer match between the requirements of each programme and the capacity of procuring authorities in complete each programme. Once the Stage 1 qualitative and quantitative assessments have been completed, an overall assessment should be made. This should provide a detailed justification of the conclusion and should recognize the limitations in any of the component parts of the assessment, both for the preferred procurement route for the programme, and for its constituent projects. An exception to this approach might be for unique/pathfinder projects which do not easily fit into a programme level assessment where a more project specific assessment may be appropriate.

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<sup>9</sup> The term 'PFI' has been replaced by 'PPP' for reasons of convenience. The same applies to the term 'department', which is replaced by 'ministry'



## Stage 2: Project Level Assessment

This stage is designed for project teams to test that the indicative VfM conclusion from Stage 1 is relevant in light of the specific characteristics of individual projects. Using both the qualitative and quantitative approach, Stage 2 should identify those projects for which, contrary to the conclusions reached at a programme level assessment, PPP is not likely to be a VfM procurement route. Stage 2 should also identify issues within projects that need further work in order to ensure that the original conclusions reached for the programme can be confidently translated at the project level. The assessment seeks to verify that the assumptions upon which the decision was taken to proceed with a PPP procurement route remain supportable in the light of prevailing market conditions in the lead up to issuing the OJEU Notice. This assessment will normally be part of a wider project level assessment that will examine issues such as affordability, strength of commercial interest, bankability and suitability of the project management team: these issues are usually components of an outline business case (OBC) upon which the decision to proceed to engagement with the market, via an OJEU notice, may be based.

The Stage 2 assessment assumes that a conclusion has already been reached that, using the best available evidence at programme level, PPP is the most appropriate procurement route and represents VfM.

### Objectives of Stage 2:

- Demonstrate that the initial decision to use PPP, based on an investment programme assessment, is valid for particular projects;
- Verify whether appropriate risk transfer arrangements are achievable;
- Where project specific issues emerge so that PPP is no longer likely to offer VfM, direct the procuring authority early on towards the possibility of using other procurement routes including switching to conventional procurement;
- Feed information back to the programme level to improve the evidence base and potential for market management;
- Provide improved cost estimates so that, as part of the OBC, procuring authorities can be confident that the project is affordable;
- Test whether the PPP solution has sufficient market interest;
- Help ensure an efficient bid process is planned within a realistic timeframe; and
- Provide the procuring team with a framework within which they can take decisions if the assessment should suggest that the market conditions are unfavourable

The outcome of the appraisal should be a clearer understanding of the suitability of the PPP procurement route for a specific project. It will also provide the procuring authority with a better understanding of the capacity needed, against that available, to take the project forward.



### Phase 3: Procurement Level Assessment

The aim of the Stage 3 assessment, which runs as a continuous assessment from the issue of the OJEU Notice to contract award, is to ensure that both procuring authorities and sponsoring departments are fully apprised of market conditions and can identify any market problems early on in the procurement process, in order effectively to evaluate whether there is any erosion of VfM.

The Stage 3 assessment is more iterative and applies throughout the procurement process from the issuance of the OJEU Notice through the Financial Close of the project. Stage 3 involves a series of ongoing 'checks' to ensure VfM.

#### Objectives Stage 3

- Ensure that a robust competitive procurement process takes place and there is a healthy level of competition;
- The financial viability and capability of bidders are sufficient to achieve VfM;
- Feed back market intelligence to projects in earlier stages of planning and procurement;
- Confirm that the proposed risk sharing is appropriate and deliverable;
- Ensure that the procurement process is efficient and equitable so that the costs emerging from competition are reasonable and stable;
- Determine if there is market abuse for failure
- Determine the appropriate project structure and level of financial flexibility

Once a project in the delivery phase, it may be examined to see whether or not VfM objectives have been achieved. This can form part of a useful feedback mechanism to build up a picture to examine the validity of the VfM decision, which types of projects procured using PPP achieve VfM and how the VfM assessment processes can be further developed. Clearly such analysis needs to be carried out by suitably objective and informed processes and institutions.





### **3. VfM practice in the Netherlands**

#### **3.1 Government investment policy**

In the last decade various branches of the Dutch government have executed a variety of major investment projects. These projects provided an opportunity to the Dutch government for creating some relatively new procurement options, which, subsequently, were added to the already existing procurement repertoire. The governments' general aim is to gain an optimal balance in price and quality of a public investment project in order to better achieve its public aims, which are basically: more quality of public service for the same money, or the same quality for less money. Procurement by means of making use of PPP has proved to deliver value for Money to the public sector. The major driver for the rise of new integrated ways of procurement is the desire to obtain more efficiency in public sector spending; in the Netherlands budgetary constraints are no valid argument to support PPP.

Obtaining the targeted satisfaction level of the envisaged user of the services is the main focus of public service delivery. The method by which a public service is delivered is essential. The success of the public service is measured by the added value the service has to the user. This philosophy differs from the more traditional role of the government as sole supplier of public goods. In the new approach it is the challenge for the government not to decide how a public service is filled in, but to decide what the service has to achieve. In the traditional approach to delivering public services the idea that when a public authority was responsible for a delivering a service this authority had to carry out this service by itself. Under a PPP approach, such an automatic link between responsibility and task execution is not self-evident. By using PPP the public sector focus changes from input oriented steering (central question: Which, and how many resources to I need?) into output oriented steering (central question: What do I want to achieve?). Within the public domain private parties increasingly participate in realizing public aims by taking over the risks they can influence better than the public sector, in consideration of the relation between quality and price. Under PPP the approach to public investment projects has changed.

In practice it means that considering a PPP type project design means that a public sector authority – within its constitutionally defined responsibilities - has to reconsider its tasks and the filling in of these tasks. A central tenet to this is that the party who best can influence a risk should bear it. To put it on operational level: each investment project has to be scrutinized for opportunities to find the best actor to manage a risk. The outcome of such an assessment influences the way a project will be procured. The main aim is to realize public aims efficient and effective.

#### **3.2 PPP VfM methodology in more detail**

Once the need for a public investment project is acknowledged the authority that has the budget chapter responsibility formulates the conditions of the project. The authority has to formulate conditions relating to: the costs of the project in terms of public budget needed, the public aim the project contributes to, the scope (what is part of the project, and what is not), and to formulate what the government wants to achieve in terms of output. Furthermore, it needs to be inventoried which permits need to be obtained, and whether (public-public) agreements with other authorities need to be concluded. Eventually all essential information is obtained in order to carry out necessary to choose the most appropriate way to procure the



project. The Public Private Comparator is the tool, which helps to indicate whether PPP is a potential attractive road to follow. Depending on the financial volume of the project the use of the Public Private Comparator (PPC) is obligatory. The PPC is a financial instrument which points out the best way of procurement for a project, expressed in an estimated number. The PPC gives insight in costs, revenues and risks of a project during its life cycle. The PPC compares a regular public procurement method (traditional, DB, DBM procurement) with procurement by means of DBFM/O. The PPC is strictly a financial instrument. And of course in the public deciding process non-financial arguments can play a role, on the programming level the financial arguments are leading.

To determine the optimal balance between price and quality 1) an inventory of risks has to be made, and 2) the risks have to be valued. Both within the scope of the project. Most of the risk categories will be similar for various types of projects. However, in every project specific – project related – risks may occur. Due to this inherent risk variance each project gets its own tailored made PPC.

Based on the identified risks the PPC estimates the revenues and costs in each phase of the project. The final report contains a specific description of the project and the investigated ways of procurement, a qualitative analysis and a quantitative analysis. Based on outcome stated in the PPC the responsible public authority (principal) decides whether to bring the project to the procurement stage, or not. More information concerning Dutch PPC practice is provided in **Appendix A** to this report.

The Public Sector Comparator (PSC) is a financial instrument which gives the principal the opportunity to compare a private bid to the public filling in of that specific bid. The translation from the private bid to the public filling in is necessary to get an accurate estimation of the value for money. A PSC is formulated during the tender of a project and like the PPC it is based on the risks, costs and revenues.

When PPP/DBFMO is chosen as the most preferred procurement tool, the project will be put out to be tendered. After being selected, private companies will have to submit bids in compliance with the tender requirements. One of the purposes of these requirements is to receive bids that are comparable with each other, and with a public variant. At the end of the procurement procedure the data contained in the Best and Last Offer of the selected tenderer will be inserted in the PSC. Based on the outcome of the PSC assessment the final choice will be made on whether going for PPP gives value for money to the principal. More information on the Dutch PSC practice is provided in **Appendix B** to this report.

### 3.3 Lessons learnt

The Dutch PPP programme started about a decade ago. The approach chosen was to work out methodologies first, prior to start tendering projects. As a consequence, it took a couple of years before the first projects were procured. At present a couple of PPP projects have reached the operational stage and new projects are coming up. In various public branches. In the coming years it has to be assessed whether the expected value for money will be materialized. The Dutch Ministry of Finance (Department for PPP and Asset Management) monitors the PPP projects throughout their operational stages. Within the framework of this inception report the Dutch MoF would like to summarize its experiences as follows:

- PPP is a challenging: in order to get a PPP programme really lifting-off a central PPP programme (i.e. a list of projects with potential to be executed by means of PPP) should be established. Based on this programme spending departments should be encouraged to sincerely invest in PPP knowledge ('no way back' approach);



- Make the PPC instrument obligatory for public investment projects of significant financial value (i.e. for infrastructure projects > € 125 mill, for utility buildings > € 25 mill)
- Take care the coordinating responsibility for PPP projects is incorporated in a cross governmental ministry. And improve the coordinating capabilities of that ministry by means of establishing a PPP Centre that provides technical and policy support to third public sector parties. The establishment a PPP coordinating body prevents government branches to develop own (perhaps less valuable) interpretations of the PPP concept;
- Make sure the projects intended to be procured by means of PPP do have enough public budget funding. A PPP project needs budget as well. And budget as a fall back option in case PPP might turn out not to be delivering value for money. Having alternative funding sources in place prevents tunnel vision;
- Introduce a PPC and PSC type of instruments, to focus discussions and promote objectification of perceived relevant project data. Take care the right benchmarks are in place. The quality of the output of the PPC and PSC assessment correlates with the quality of the input. Don't fool yourself!;
- Concerning the project specifications: focus on the desired output instead of the input. It is our experience that a acquiring a focus on output requires a fundamental change in approaching the expected project results. A challenging task for civil servants. In particular, because proposals to change (almost) any project specification and/or condition after reaching financial close may result more than expected additional costs;
- Changes in the scope and in the output will obscure the underlying benchmarks and will most likely raises the costs. The public sector should invest in getting the starting point as clear as possible and getting the right project-data in order to get the best value for money.

Ministry of Finance (Department for PPP and Asset Management), March 2007



## 4. VfM practice in the United Kingdom

### 4.1 What is Value for Money (VfM) and why is it important?

Value for money is the optimum combination of whole-life costs and quality (or fitness for purpose) of the good or service to meet the user's requirements. VfM is not a choice of goods or services based on the lowest cost bid.

Whether or not to use PFI as a procurement tool is based on whether it represents VfM in procurement. Thus, in order to undertake a well managed procurement, it is necessary to consider *up-front* and at the *earliest* stage of the procurement process, the key drivers of VfM.

VfM is a *relative* concept that requires comparison of the potential or actual outcomes of alternative procurement options usually comparing PFI with conventional procurement. It therefore requires a high degree of estimation, especially where experience or data is limited.

### 4.2 UK PPP VfM methodology

VfM assessment follows a three stage process:

1. Programme level assessment to ensure that VfM assessment takes place at the *earliest* stage possible. This therefore takes place around the annual budgeting round when any programme of investments (i.e. a portfolio of similar investment projects) is being considered by a particular authority. The programme level assessment will likely use high level estimates developing to more detailed inputs at the stage 2 project level assessment;
2. Project level assessment which takes place at the outline business case stage and is conducted on a specific project shortly prior to engagement with the market;
3. Procurement level assessment which takes place on an ongoing basis during the procurement phase (i.e. post OJEU up to financial close). This will concentrate in particular on the quality of *competition* throughout this phase and, for example, the impact of different financial structures on contract flexibility (e.g. impact on the cost of any voluntary contract termination).

VfM methodology is underpinned by assessing factors that affect *viability* (e.g. can clearly defined outputs be included in a contractual structure with appropriate risk transfer?), *desirability* (e.g. are there benefits from procuring the service through a long term contractual relationship that outweigh other forms of procurement?); and *achievability* (e.g. is there market interest, is the project bankable and can the authority manage the complex project preparation and procurement process?).

It is also important to distinguish between VfM and affordability – assessment of both takes place in the project preparation stage but affordability is concerned with issues of the procuring authority having the necessary resources over the life of the contract to pay for the services delivered. Similarly, the accounting treatment of a PFI project does not form part of the VfM assessment. Procuring authorities should not compromise VfM by transferring risks unnecessarily in order to get a particular balance sheet outcome: risks should be born by



those parties best able to manage them. It is also HM Treasury policy that VfM should not be achieved at the expense of employee terms and conditions.

For stage 1 and stage 2 processes, VfM comprises both a qualitative and a quantitative assessment. The quantitative assessment should be considered a *support* tool for making an overall assessment. It is not therefore the sole criterion. Where the results of the *quantitative* assessment are marginal or where the inputs are uncertain, then more weight should be given to the *qualitative* assessment. A standard VfM spreadsheet has been developed by HM Treasury to carry out the quantitative assessment.

The most recent approach to VfM involves carefully testing the case for including soft services (i.e. the day to day supporting services required for operation of the asset such as catering, cleaning, security), examining the balance between affordability and the need for contractual flexibility, and the optimal contract length (e.g. if demographic changes are likely or if the need for service is likely to change, then a long contract length might not be appropriate). This follows from the lessons learnt to date with PFI procurement (discussed below).

### 4.3 Lessons learnt

#### Project size

VfM is unlikely to be achieved using PFI as a procurement tool in low capital value projects due to the relatively high level of procurement costs. Accordingly, PFI is not considered appropriate for projects with capital expenditure of less than £20m.

#### ICT

PFI is not considered suitable for projects where there is rapid technological or other change which makes it difficult for procuring authorities and bidders to predict service delivery requirements and include sufficient contract flexibility at a reasonable price. Accordingly PFI is not for example considered to deliver VfM in ICT procurements.

#### Soft services

Evidence from the recent examination of operational PFI procured projects, shows that soft services are seen as performing *less* well on average than the very high scores given to other elements of the PFI framework. The UK Government's view is that the evidence on satisfaction with soft services does not therefore demonstrate VfM as consistently as other elements of the framework, and that the analysis of service outcomes suggests that, while standards are no worse than in non-PFI structures, PFI has not led to a step change in soft service delivery. Accordingly, recent VfM guidance requires that public authorities now rigorously prove the case for including soft services in PFI projects.

#### Flexibility

While generally PFI contracts appear accurately to specify the services required, public sector managers believe that the levels of flexibility built into (generally older) contracts to undertake minor variations could be improved. Evidence suggests public sector managers appreciate the long-term certainty over maintenance and service provision created by PFI, but want greater flexibility to make minor variations and greater alignment of incentives to agree and complete variations. To ensure that variations can be undertaken more flexibly in future PFI projects, the UK Government is ensuring that the flexibility required is adequately



assessed both when scoping the project's requirements and throughout the procurement process, in particular in the levels of flexibility offered by different bidders.

#### Contract term

Contract lengths should be driven by VfM not affordability: there may be instances where a long contract length can reduce the monthly unitary charge making the project appear more affordable (e.g. through longer loan periods) but the contract length is not optimal in relation to the asset life or likely changes and therefore unlikely to achieve VfM. To help ensure this, contract lengths are likely to be established for different sectors and with a maximum cap of 30 years.

#### Project Maturity

It is important that procuring authorities allocate sufficient resource adequately to prepare and develop projects before engagement with the market: making late changes to a project once procurement has commenced adds to costs for both for the public and private sector and can delay service delivery.

#### **4.4 Further reading**

*Value for Money Assessment Guidance – November 2006*, HM Treasury available on [http://www.hm-treasury.gov.uk/media/4/4/vfm\\_assessmentguidance061006opt.pdf](http://www.hm-treasury.gov.uk/media/4/4/vfm_assessmentguidance061006opt.pdf)

A wide range of Value for Money Reports on individual projects or groups of projects produced by National Audit Office, available on [www.nao.gov.uk](http://www.nao.gov.uk)

Partnerships UK  
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## 5. Key Observations by Twinning VfM Experts

The twinning VfM experts have made various observations with respect to the current approach in the Czech Republic. These are summarised below.

### 5.1 Positive elements of the current Czech VfM framework

#### Regulatory provisions

- The Public Procurement Act<sup>10</sup> provides a legal framework for the procurement of key infrastructure and public services. The Concession Act (March 2006)<sup>11</sup> provides the framework and broad parameters for development of PPPs. Both Acts became effective on 1<sup>st</sup> July 2006. The Public Procurement Act governs public sector procurement in general. The purpose of the Concession Act is to structure key decision making on concessions (including PPPs), and subsequent procurement thereof.
- The MoF has established two important institutions assigned with the task of assessing the viability of PPP projects to facilitate implementation: a PPP Centrum and a Department for Regulation of PPP Projects.
- The MoF has produced a list of assessment criteria to be applied to PPP projects.
- With significant support from the PPP Centrum the MoF has prepared and published the first draft of a standardised concession contract. Additional guidance materials have also been produced relating, for example, to risk assessment, PPP management and procurement of tertiary advisers.

#### Programme level assessment

- The Czech Government has taken a firm policy on the promotion of PPP in public investment project delivery<sup>12</sup>.
- A number of pilot PPP projects have been identified by the Czech government. Based on the Twinning VfM experts' knowledge of these projects, the use of PPP as the procurement tool does not appear unreasonable.
- The Czech MoF is encouraging Ministries to consider how assets/services can be procured (including PPP) at the programme level.

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<sup>10</sup> Act No. 137/2006.

<sup>11</sup> Act No 139/2006.

<sup>12</sup> Government resolution No. 624/2003, 7/2004 and 791/2004, resulting in:

- legislative changes necessary for systematic PPP implementation
- a timetable for the procurement of a number of pilot PPPs
- assessment criteria for the pilot PPP projects
- establishment of a cross-departmental PPP assessment panel





### Project level assessment<sup>13</sup>

- For its pilot projects the Czech Ministry of Justice (MoJ) has engaged advisers, a number of which have significant international experience, (though the terms of engagement were not reviewed).
- Best practice procedures for the appointment of external advisers have been developed by the PPP Centrum. This has been used by the MoJ for its pilot projects.
- The MoJ draws on input from other Ministries (e.g. Ministry for Regional Development and the MoF) and relevant bodies/advisers with experience in the region.
- Pilot projects are reviewed by a Project Board (comprising the MoF, PPP Centrum and the relevant Ministry (i.e. promoting the project)), at OBC stage prior to issue of tender documentation. The Project Board implements and reviews the whole project cycle and takes all necessary and key decisions. In accordance with the Concession Act the constituents of the government have the right to review the OBC concerning State level PPP projects prior to commencement tender stage.
- Value for money (VfM) assessment is a component of the OBC according to the requirements of regulation No 217/2006. The scope of the MoJ's PPP justice court project has been modified further to the development of a Public Sector Comparator (PSC) which initially showed only a very limited cost saving; and the Karlovy Vary courthouse PPP project has been cancelled.
- MoF recognises that it does not currently have the necessary tools and procedures in place to ensure effective implementation of any guidance which is produced. A paper is being produced (for inter-ministerial approval) so that general guidance applies to all projects and the MoF will be better placed to ensure effective implementation.

## **5.2 Weakness in the current approach to PPP VfM assessment**

### Institutional framework

- MoF is not adequately resourced to develop the necessary guidance, to support Ministries involved in PPP projects and to review projects at key stage review.
- Whilst the PPP Centrum was established to undertake much of the above and assist the MoF with effective implementation of its PPP policy, the current absence of any budgetary support and a formal mechanism under which PPP Centrum capacity is accessed by MoF, means that this has largely not happened.
- MoF's constraints on an engagement mechanism with the PPP Centrum is likely to have contributed to the departure of key PPP Centrum personnel, further adversely affecting the PPP Centrum's ability to build up a core of technical expertise and so provide the necessary VfM support (were it engaged by Ministries).

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<sup>13</sup> Primary source of information for project level assessment: the Czech MoJ, which pilot PPP projects (courthouse Usti nad Labem, and prison project) have reached the OBC stage





- MoF advised that it is anticipated that a contract of engagement would be entered into with the PPP Centrum in early January. It was not clear what level of budgetary support would underpin this prospective engagement.
- Clearly, were the PPP Centrum to be disbanded (for policy or financial reasons), a potentially negative perception by both the public and private sectors of the Government's commitment to development of the PPP programme would need to be addressed.

#### VfM methodology

- The concession act and related regulation set basic rules of process, OBC preparation, VfM assessment etc. Detailed guidance has not yet been produced to ensure that Ministries can follow a consistent approach and adopts best practice procedures.
- Perception is that there is a tendency for the MoF to focus on form rather than substance. VfM analysis should include an appropriately rigorous interrogation of the key assumptions.
- VfM is still a fairly unfamiliar concept across the public sector. It is possible that Ministries believe that so long as risk is transferred VfM will always be achieved, which is not necessarily the case.
- Collation of empirical data on project performance across the public sector, even if adverse (i.e. delays/cost overruns/inadequate lifecycle investment), is necessary in order to establish credible project public sectors for the VfM analysis. Incentives not to collect negative performance data need to be addressed.

#### Project practice

- Communication across Government of the key drivers to PPP would appear to require further support: it is not clear whether the principle advantages of PPP are yet fully and consistently understood across Government (i.e. improved service provision, reduced delays in completion of the project etc).
- VfM is still a fairly unfamiliar concept across the public sector. It is possible that Ministries believe that so long as risk is transferred VfM will always be achieved, which is not necessarily the case.
- MoJ, as one of the line Ministries implementing PPP projects, reported that it would benefit from more central support, and that there was a lack of clarity in terms of the VfM assessment criteria to be applied by the MoF.
- It might be advisable to reduce the weighting attached to the quantitative VfM assessment for the MoJ's courthouse PPP project: given that the PSC is likely to be largely hypothetical (i.e. not based on Czech empirical evidence) more weight needs to be given to 'qualitative' aspects in the VfM analysis.
- Whilst the MoJ is receptive to feedback and keen to understand the lessons learned by others with experience of PPPs and the procurement process, it is not clear if this approach is necessarily representative of other line Ministries, and municipalities preparing PPP projects.
- The experience gained from PPP pilot projects implementation and management should be analysed, generalized, and subsequently be used for further developing of standardized methodology.
- The Czech MoF has no right of veto on the Project Board level. Ability of MoF to enforce its concerns depends in part on its relationship with the relevant Ministry.



## 6. Recommendations to improve PPP VfM methodology

### 6.1 Introduction

The fact-finding mission for Component 1 (VfM-methodology) was the first expert activity carried out under this Twinning initiative. Unfortunately, at the time of the fact-finding the partnership arrangement between the CR MoF and the PPP Centrum was not formalized<sup>14</sup>..

Taking into account the current PPP context in the Czech Republic, the implementation of the proposed actions contributes to getting a basic VfM methodological framework in place within a reasonable time frame. Experience shows that enhancing the quality of a once established VfM methodology is an ongoing process. In order to maintain and improve the quality of the adopted VfM guidance continuous testing of it in PPP projects needs to take place.

The list of recommendations mentioned below addresses not only technical improvements of the current Czech PPP VfM practice, but comprises also more institutionally oriented elements. The implementation of particular proposals (e.g. introducing a method to collect, process and analyze projects' financial data) might recommend attracting Technical Assistance from the private sector. Based on perceived urgency a distinction is made between activities to be carried out within the scope of Component 1 and activities under the rest of the Twinning project.

### 6.2 Proposed Recommendations to be implemented within the scope of Component 1

#### Recommendation 1 - VfM methodology in general

Basic VfM Guidance should be produced. This should include information on how to develop a PSC (incl. discount rate assumptions). The VfM Guidance should place the PSC in context and include an appraisal of qualitative factors.

#### Recommendation 2 – VfM assessment on project level

Guidance on the development of the OBC/VfM & affordability assessment should be produced.

#### Recommendation 3 – Role of the PPP Centrum

The full participation of the PPP Centrum in this Twinning project should be secured as soon as possible. It is advised that the PPP Centrum works out a draft VfM methodology fit to be applied within the Czech institutional PPP context. The Twinning partners can perform reviews on materials produced, and are available for delivering tailored made advice. Without the proper support of the PPP Centrum it is perceived as highly unlikely the CR MoF will be able to draft the guidance itself due to resource constraints.

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<sup>14</sup> Full cooperation of the CR PPP Centrum on the Twinning activities is one of the prerequisites for a successful implementation of the Twinning project. See for further information on the validity of key-assumptions on the project the General Inception Report, approved by the Project Steering Committee on December 5<sup>th</sup> 2006



### 6.3 Further recommendations

The following recommendations contribute to ensure the proper institutional embedment of VfM methodology. Due to the nature of the proposed actions, their implementation requires more time.

#### Recommendation 4 – Quantification of VfM

The MoF should consider putting in place procedures to ensure that empirical data is captured which may then be used to facilitate and enhance the credibility of the VfM analysis.

#### Recommendation 5 – Role of the Steering Committee

The Steering Committee established for review of the pilot PPP projects at the OBC stage should have its remit extended to the review of all PPPs and the Committee should have strong technical support (e.g. via MoF/PPP Centrum) to enable it to make informed decisions. The precise scope of the decision authority of the Steering Committee should be defined.

#### Recommendation 6 – Strengthening the coordinating role of the CR MoF

There needs to be a mechanism to ensure effective and consistent implementation of PPP guidance across all Government Ministries and sub-national public authorities procuring PPP projects (a role normally played by a cross departmental Ministry such as Finance). An example might be powers for, say, the MoF to be able to veto projects in the event that they fail to meet the minimum criteria as set out in guidance.

#### Recommendation 7 – Staffing issues

The CR MoF itself must be adequately resourced and have access to appropriate external support. The establishment by the CR MoF some years back of the PPP Centrum appears to have been a very sensible first step showing foresight by Government for the technically complex requirements of a PPP programme. The perceived current lack of support for such a body is likely to lead to future problems especially in the light of a gathering number of projects likely to come to market when the need for strong technical support within Government will be greater than ever

#### Recommendation 8 – Dissemination of PPP expertise

Further inter-ministry workshops could be arranged to improve understanding of the proper working of the VfM concept in PPP projects. Such workshops will only contribute to promote an uniform application of VfM concept provided the coordinating role of the CR MoF on PPP methodologies is enhanced.

### 6.4 Time table implementation of the recommendations concerning Component 1

Provided the Project Steering Committee approves the Recommendations 1 to 3 (i.e. recommendations within the scope of Component 1), and provided the BC can make sufficient resources available, the Twinning Contract allows for a period of three months to support drafting the materials. Based on PSC approval at its March 12<sup>th</sup> 2007 meeting this would imply that Activity 1.2 (drafting VfM methodology) will run until the end of June. Taking uncertainties and summer holidays into account it is most realistic to assume that Activity 1.3 (Provision of training) can take place in September 2007.



Table 1: Proposed time table implementation Activities 1.2 and 1.3

Component 1	2007						
	March	April	May	June	July	August	Sept.
Act. 1.1 Approval Inception Report							
Act. 1.2 Drafting guidance							
Act. 1.3 Training							

**Appendices and references:**

*Appendix A:* Public Private Comparator guidance, Ministry of Finance, the Netherlands, August 2002

*Appendix B:* Public Sector Comparator guidance, Ministry of Finance, the Netherlands, August 2002

*Web-link to:* Value for Money Assessment Guidance, HM Treasury, November 2006:  
[http://www.hm-treasury.gov.uk/media/4/4/vfm\\_assessmentguidance061006opt.pdf](http://www.hm-treasury.gov.uk/media/4/4/vfm_assessmentguidance061006opt.pdf)