NAO
National Audit Office

A Framework for evaluating the implementation of Private Finance Initiative projects: Volume 1

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A Framework for evaluating the implementation of Private Finance Initiative projects: Volume 1

This volume has been published alongside a second volume –
A Framework for evaluating the implementation of Private Finance Initiative projects: Volume 2

This document has been prepared by the National Audit Office as part of its Good Governance programme. Good Governance projects aim to draw on the NAO's cross-governmental experience and independent perspective to help organisations delivering public services achieve excellence in financial management, operational efficiency and quality of service.

In particular, Good Governance projects aim to:

- Promote improved management of risks to the effective delivery of public services and stewardship of resources;
- Focus on issues that, in the judgement of the client organisation, are timely, relevant and important;
- Contribute to the delivery of efficiency savings, and, where possible, direct financial impacts; and
- Bring a wider perspective to the client organisation's practice by drawing on the NAO's knowledge of financial management and service delivery issues across government.

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This report can be found on the National Audit Office web site at www.nao.org.uk

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PREFACE

This report sets out the issues that need to be considered in evaluating whether PFI projects have been well thought through and then implemented effectively. Such considerations are central, although not exclusive, in assessing whether good value for money is being obtained from PFI projects. A number of other issues – including a comparison of what performance at what cost might have been obtained over a typical 25 to 30 year PFI contract period from other procurement routes – are also key, although somewhat hard to assess.

In this report, we present an evaluation framework covering the lifecycle of projects from initial strategic analysis to the mature operational phase, in terms of indicators that span six key business management themes. It builds on and updates our previous report in 1999, *Examining the value for money of deals under the Private Finance Initiative*. Since then, a substantially greater number of deals have been closed and a growing proportion are now in the operational phase. With the accumulation of experience it is possible to address the evaluation of PFI projects in this phase.

Part 1 describes the updated approach to assessing PFI project implementation. Part 2 outlines the evaluation approach that can be used in practice. Volume 2 provides full details with Annex 1 of that volume providing a guide to other government documents that address the design and implementation of PFI projects.

The Framework is intended for use primarily by evaluators, but it will also be of assistance to those implementing PFI projects on a day to day basis. In addition, many of the issues considered are applicable to non-PFI procurements. Evaluation is not a static activity however, and readers need to be aware of new or revised guidance and the results of detailed assessments of PFI projects in carrying out this work. This Report is in line with developments up to and including Budget 2006.

PART ONE

An updated approach to assessing whether PFI projects are being implemented well

This part of the report outlines an updated approach for assessing whether PFI projects are being implemented well, across all phases of the project life-cycle, according to a set of key business-management imperatives. It also sets out how the framework can be applied by project managers, Private Finance Units and external evaluators.

An updated approach to assessing PFI's value of money has become necessary

1.1 In 1999, we reported on how we examined the value for money of deals reached under the Private Finance Initiative[1]. The analysis was based on four "pillars", each of which comprised a number of detailed aspects. The four pillars were:

- make the project objectives clear;
- apply the proper processes;
- select the best available deal; and
- make sure the deal makes sense.

1.2 That framework's primary focus was on issues that arise during the procurement and negotiation of deals, rather than on those arising during the life of a contract. At the time of our 1999 report, few deals had reached an established operational phase and it was not then possible to extend the framework to cover this aspect. The framework outlined in this report builds on but replaces the four "pillars".

There is no existing framework or guidance to assess deals in operation

1.3 The Treasury and the Office of Government Commerce (OGC) have produced substantial guidance to assist Public Authorities in the procurement and evaluation of PFI projects, including the 2004 Treasury publication *Value for Money Assessment Guidance* which set out a new approach to assessing the value for money of PFI[2]. Most of the current advice to Authorities also relates, however, to the procurement of a PFI project and does not comprehensively address the operation of the subsequent services, which are typically provided over a 30-year period. Achieving value for money from PFI depends as much – if not more – on getting the required operational performance as on getting the best deal.

External interest in how to assess the implementation of projects is high

1.4 Discussions with external parties in the public and private sectors suggested to us that there was a substantial demand from those involved in designing and implementing PFI deals for an overarching framework for assessing whether PFI is being implemented effectively, particularly in relation to a project's operational phase. The Treasury's 2003 publication Meeting the Investment Challenge also pointed to the need for such work[3].

1 National Audit Office: *Examining the value for money of deals under the Private Finance Initiative* (HC 739 1998-99).
2 HM Treasury: *Value for Money Assessment Guidance* (August 2004).
3 HM Treasury: *Meeting the Investment Challenge* (2003).

Our updated framework makes use of top-level indicators

1.5 In building the analytical framework, we asked what processes and outcomes are needed to achieve a successful PFI project. We did this in part by reviewing the work in over 50 NAO reports on PFI and PPP projects that we have published. Our analysis then drew heavily on discussions with those in the private and public sectors including with Private Finance Units in four government departments, HM Treasury, Partnerships UK and 4ps. In addition to existing official guidance, we also drew on the Treasury Budget 2006 publication, PFI: Strengthening Long-Term Partnerships, which focuses on improving value for money especially in managing the operational phase of PFI projects[4].

The indicators are top-level statements of what should be achieved to deliver and run effective PFI projects

1.6 Our framework comprises a series of management themes which span the various stages in the life of a PFI project, from "Strategic Analysis" to "Mature Operation". The essentials for evaluation for each management theme at each life cycle stage are summarised by high level indicators noted at Figure 1, each of which is supported by hierarchical sub-indicators. The further down the hierarchy, the more specific and detailed the sub-indicators become.

Project implementation can be divided into six phases

1.7 We identified six distinct life-cycle phases through which a PFI project passes, each involving a specific and separable set of issues that need to be considered. These six individual phases are:

1 **Strategic Analysis.** This phase covers the steps followed by a procuring Authority up to outline business case and the decision to procure through a PFI solution. This phase aligns with the Stage 1 (the investment decision to go ahead with the project) and Stage 2 (the decision on how to procure the project) processes in the 2004 Treasury VFM guidance.

2 **Tendering.** This covers the steps undertaken up to the selection of a preferred bidder. This phase is equivalent to Stage 3 in the 2004 Treasury VFM Guidance.

3 **Contract Completion.** This relates to all the activity between selection of preferred bidder and financial close[5].

4 **Pre-Operational Implementation.** This covers the phase between contract close and the start of operational services with a new (or refurbished) asset. It covers procurements where the construction or delivery of infrastructure is part of the contract.

5 **Early Operational.** This relates to performance over the first three years after the start of operational services. Three years takes in the period of initial bedding down of the contract and the development of a long-term relationship between both parties.

6 **Mature Operational.** This covers performance from the beginning of the fourth year in which services are operational until the end of the contract[6].

Past NAO work indicates that six key business-management themes come into play at any phase of a PFI project's lifecycle

1.8 Based on our discussions with private and public sector representatives and by considering our previous work, we were able to define six key business-management themes that apply at every phase of a PFI project:

The project fits with the business requirements of the Authority. The project design should seek to be an optimal fit with the Authority's core business requirements and continue to deliver an optimal outcome.

PFI is the appropriate delivery mechanism. The decision to procure through and continue with a PFI route must be clearly demonstrated and be considered better than any alternatives.

Stakeholders support the project's progress. Relevant stakeholders should be engaged and satisfied with the development of the project and the Authority must manage stakeholder interests appropriately.

There is good quality project management. The project management structure should be designed to ensure that outcomes from each phase are optimal for the business.

4 HM Treasury: *PFI: Strengthening Long-term Partnerships*, (2006).
5 Stage 3 of the Treasury Guidance also covers this phase.
6 Experience in this phase is limited to date, and it is likely that our framework will need to be amended as more experience and evidence accumulates.

There is an optimal balance between cost, quality and flexibility. The Authority needs to achieve and maintain a good value deal which is affordable, meets service requirements and provides a financial structure allowing for flexibility in the event of changing business needs.

Effective risk allocation and management is taking place. Risks need to be placed with the party best able to deal with them and proper consideration given to the trade-off between transferring risks and the costs of doing so.

1.9 These six themes have been ordered to reflect the process of constructing an effective PFI deal and subsequently receiving the required services. For example, good quality project management is irrelevant if the project does not have the support of relevant stakeholders. In turn, stakeholders should not be engaged and managed if the Authority has not, at the least, already demonstrated that PFI is the appropriate delivery mechanism for a project that satisfactorily fits with its business requirements. Furthermore, the full benefits of good project management structures are only realised if the Authority is able to secure a deal that is affordable and has a good allocation and management of risks.

The indicators are arranged in a matrix laid out by project phase and business theme

1.10 As all six business themes apply across all six project life-cycle phases, it is possible to set out the indicators in a matrix, as shown in **Figure 1 overleaf**.

The matrix framework is intended as a tool to assess PFI project implementation but is not a replacement for official guidance

1.11 Our framework can be used in a number of ways. Primarily it is intended to set out the principles which value for money auditors such as the National Audit Office can apply. However, service managers and lead project officers can also use it to monitor and assess their own individual projects.

1.12 Private Finance Units also have an interest in individual PFI projects and can use the framework in the same way, but they also need to review PFI programmes as a whole. The OGC Gateway Review process defines an investment programme as "a portfolio of projects that have certain common characteristics and which are selected or commissioned, planned and managed in a co-ordinated way and which together achieve a set of defined business objectives"[7].

1.13 Programme evaluation also needs to take account of issues including:

- whether lessons from earlier projects have been applied to later ones to improve design and performance;
- whether the opportunities for economies of scale across projects have been exploited; and
- whether the programme has been planned in a way that is sustainable within supply capacity.

1.14 Our framework is designed to complement guidance such as that issued by the Treasury. The 2004 Treasury VFM Guidance sets out a range of requirements within the process, aimed at achieving good outcomes. Our framework provides a methodology for considering whether good outcomes in the process of implementation have been achieved. It remains important however that official guidance is used fully to achieve well designed and good value for money PFI projects in the first place.

7 Office of Government Commerce: *Gateway Review 0: Strategic Assessment.*

1 The Matrix

Theme	Phase: Strategic Analysis	Tendering
The project fits with the business requirements of the Authority	■ The best form of project to pursue has been selected ■ Top level specifications for the required services have been drawn up	■ The output specifications in the tender properly address the business requirements ■ Robust payment and performance-measurement regimes are in place that clearly reflect optimal business requirements ■ The Authority is clear about its approach on balancing flexibility for change against price for the proposed deal
PFI is the appropriate delivery mechanism	■ The project has been assessed as being part of a suitable investment programme for PFI ■ There is a good outline business case justifying a PFI procurement route ■ The qualitative reasons for proceeding with PFI are clearly justified ■ The quantitative reasons for proceeding with PFI are clearly justified ■ Service performance under current arrangements has been baselined for future monitoring of PFI contractor performance ■ The optimal project structure for the Authority is acceptable to potential private sector partners and funders	■ The Authority has encouraged innovation by allowing a range of solutions to be proposed ■ The Authority has checked that the justification for a PFI solution as contained in the business case still holds
Stakeholders support the project's progress	■ A strategy is in place to communicate with stakeholders on an ongoing basis ■ Relevant stakeholder groups have been consulted in producing the outline business case	■ Key stakeholders have maintained commitment to the project
There is good-quality project management	■ Governance structures for the project have been set up ■ A realistic timetable for the procurement of the project has been laid out ■ A well resourced and experienced project team has been put in place for the procurement ■ The required form of consultation with staff and users during the procurement have been identified ■ The senior management input required for a successful procurement has been identified	■ A good project team is maintained during the tendering phase ■ A clear and realistic tendering timetable is in place and maintained ■ Likely contract issues have been identified before the start of tendering ■ Procurement costs have been controlled ■ A clear process for evaluating bids and setting assessment criteria is in place ■ The Authority is clear about the required governance arrangements for the project once it is operational

Contract Completion	Pre-Operational Implementation	Early Operational	Mature Operational
■ The project strategy and likely outcome have been re-evaluated to ensure they are still in line with business needs ■ The contract meets the Authority's business requirements	■ The asset is being delivered to contractual specification	■ Service-provision outturn is meeting contractual requirements ■ The asset is fit for purpose ■ Where contractual services differ from business requirements, the Authority is acting to align them	■ Service-provision outturn is meeting core business requirements ■ The asset if still fit for purpose and is maintained to a good standard
■ A review confirms that alternatives were evaluated and fairly eliminated	■ The baselining of service provision has continued (to aid future assessment of PFI service quality)	■ *[The Authority is sure that maintaining the PFI route is the best option in the event of poor construction outturn.]*[1]	■ The Authority has improved its performance since the PFI asset became operational ■ Maintaining the PFI deal for future service provision is assessed as the best value for money
■ Key stakeholders support the agreed deal	■ Key stakeholders have been kept informed of project progress	■ There is a good level of stakeholder satisfaction	■ A good level of stakeholder satisfaction is being maintained
■ Good procurement management has been exercised during the preferred bidder stage ■ Appropriate contract-management arrangements are in place	■ A good post-procurement evaluation has been carried out ■ All outstanding issues from contract close are resolved ■ There is provision for effective oversight and resolution of material problems arising ■ Systems are developed to deal with the new asset and service provision ■ Governance arrangements are still appropriate ■ Correct skills transfer within the public sector has taken place from procurement to operational contract management	■ The governance structures are being used appropriately ■ Relationships between Authority and contractor are working well ■ The Authority ensures that the project team have appropriate skills and knowledge for good service provision	■ The governance arrangements are still appropriate ■ Good and constructive relationships between both parties are being maintained ■ The Authority takes steps to ensure that the project team continue to have the appropriate skills and knowledge for good service provision ■ *[Has the Authority taken steps to plan for the end of the contract]*[2]

1 The Matrix *(continued)*

Theme	Phase: Strategic Analysis	Phase: Tendering
There is an optimal balance between cost, quality and flexibility	■ Market soundings have been made to generate maximum competition for a PFI solution ■ The Authority can be confident that the specification for the project will be affordable ■ The optimal balance of the proposed project has not been compromised by favourable accounting treatment	■ Quality bids addressing core business requirements have been received ■ The economically most advantageous bid has been selected
Effective risk allocation and management is taking place	■ The Authority has fully assessed risks associated with the project ■ The Authority has managed procurement risks well	■ Risk best managed by the private sector is being transferred as part of the proposed contract ■ Procurement risks have been identified and risk-management procedures put in place

Source: National Audit Office

NOTES

1 This indicator is only applicable in the event of the asset being deemed to be totally inappropriate for the Authority's business requirements.

2 This indicator need only be considered when the PFI contract is nearing its end.

Contract Completion	Pre-Operational Implementation	Early Operational	Mature Operational
• The deal is affordable in the short and long term • Competitive financing has been achieved • The final agreed deal is the economically most advantageous solution. • A review is conducted to ensure that accounting treatment has not compromised the deal's optimal balance	• Price increases only relate to new priority changes needed by the public sector on terms that are good value for money	• Affordability of the deal is being maintained • Both parties are seeking to maximise quality	• Affordability of the deal is being maintained • Both parties are seeking to maximise quality • Periodic benchmarking for price and quality is taking place
• The final agreed risk transfer contained in the contract has been reviewed for appropriateness • The Authority has a risk-management plan for use for when the contract goes live	• Risk-mitigation procedures are working properly	• The allocation of risk has been sustained operationally • The risk implications of changes to the contract are consistent with the risk that was originally transferred • The Authority's risk-management procedures are updated and working in line with changing circumstances	• Risk transfer remains optimal • The Authority's risk-management procedures are updated and working in line with changing circumstances • Accounting treatment for the asset remains consistent with the actual risk transferred to the private sector

PART TWO

Making use of the matrix: the audit criteria

This part provides a phase by phase guide to using the matrix for evaluating PFI projects at each main point in their life-cycle. Each of the six sections in Part 2 addresses one life-cycle stage, and what would be expected for each of the business themes. This is best read as a summary which sets out the priorities. Evaluators and others who wish to inform themselves of the detail can refer to Annex 1 and Volume 2.

2.1 Strategic Analysis

2.1.1 In this phase, analogous to Stages 1 and 2 of the 2004 Treasury VFM Guidance, the Authority should be producing a scope for the project and then determining whether seeking a PFI solution is the best procurement approach. The priorities for each of the themes during Strategic Analysis are:

- **The project fits with the business requirements of the Authority**

  The Authority should have established a clear priority for the services being procured through the project irrespective of procurement route. The justification for the need should be through an investment appraisal which answers key questions in accordance with the guidance in HM Treasury's *Green Book*[8]. The Authority should have drawn up top level specifications for the required services expressed in output terms.

- **PFI is the appropriate delivery mechanism**

  The Authority should identify the most suitable procurement route, firstly through assessing the project as part of a departmental investment programme and then specifically through the completion of an Outline Business Case (OBC). The OBC should clearly justify proceeding with the project through PFI for both qualitative and quantitative reasons[9]. The Authority should baseline current service provision to facilitate future realistic assessment of a PFI contractor's performance. The project structure has to be optimal for the Authority but within the capability of the private sector to deliver the required outcome. This will require the private sector being aware of the project and the Authority's requirements through market soundings by the Authority.

- **Stakeholders support the project's progress**

  The Authority should have identified potential stakeholder groups, the diversity of their interests and at what stages the support of individual groups are important to a successful project. This requires a communication strategy and making best use of feedback, including a reappraisal or stocktake on progress when there are significant changes in stakeholder views. The OBC should be preceded by early consultation with key stakeholders including staff and end-users where there can be benefits to the asset design and service specifications of the project.

8 HM Treasury: *The Green Book: Appraisal and Evaluation in Central Government* (2003).
9 The outline business case should justify the length of concession agreement for the contract and also clearly demonstrate why including soft service provision is justified. These two issues are addressed in the recent HM Treasury publication: *PFI: strengthening long-term partnerships* (March 2006).

- **There is good quality project management**

  There should be a good structure for the subsequent PFI procurement. This is maximised by a thorough analysis of the options for delivering the project. The quantum and timing of resource and skills requirements should be identified. This should be linked to a well thought out procurement timetable that encourages competitive tension. Key staffing (for which a dedicated resource is recommended) and roles on managing the project should be identified and be in place at this early stage. There should be an appropriate governance structure to control the procurement. Good project management is not optimised by a group operating within a silo. They have to run the process for consulting with stakeholders and they need the periodic commitment of senior management input and oversight.

- **There is an optimal balance between cost, quality and flexibility**

  The Authority should be confident that the solution is affordable based on an analysis of the potential costs of the project and the likely funding streams. Maximising competition by sounding out the market is the primary way to enhance value for money. The project structure should be neutral of balance sheet accounting treatment.

- **Effective risk allocation and management is taking place**

  The Authority should have identified the scope for risk transfer in advance and settled on an optimum transfer, allocating risks to those best placed to manage them. There are a separate set of risks associated with proceeding with the project. These risks have to be identified and realistic procedures put in place to mitigate such risks if they occur.

2.2 Tendering

2.2.1 This phase is equivalent to Stage 3 of the 2004 Treasury VFM Guidance. Based on a substantiated decision to use PFI, the intended outcome of the Tendering stage should be a preferred bid offering the best possible value for money. In evaluating projects, evidence should be sought which indicates that the priorities for maximising VFM were addressed:

- **The project fits with the business requirements of the Authority**

  The business requirements should have been reflected in rigorous output specifications, issued as part of the tendering documentation to prospective bidders. This should be consistent with robust payment mechanism and performance measurement regimes that have already been formulated and are based on business requirements. The documentation should also include adequate procedures for managing future changes to the Authority's requirements.

- **PFI is the appropriate delivery mechanism**

  The Authority should have encouraged innovation and the private sector has put forward a good range of proposed solutions. The Authority should also have undertaken a review of the project to enable it to conclude that the PFI solution is either still worthwhile or take early corrective action to put the procurement back on track.

- **Stakeholders support the project's progress**

  The Authority should be maintaining the commitment of key stakeholders to the project, either through consultation in the production of output specifications or the approval of the most economically advantageous bid.

- **There is good quality project management**

  A good quality project team should have been maintained. The Authority needs to have had assessment criteria and processes for evaluating bids, should have identified key contractual issues and indicated its thinking on possible governance arrangements. These arrangements should have been in place before any invitation to tender. The Authority should have maintained a clear and realistic procurement timetable with the mechanisms to control procurement costs.

- **There is an optimal balance between cost, quality and flexibility**

  The Authority should have selected the most economically advantageous bid from a range of good quality bids that addresses its core business requirements.

- **Effective risk allocation and management is taking place**

  The risks best managed by the private sector should have been transferred as part of the proposed contract and the Authority's risk management plan updated where applicable.

2.3 Contract Completion

2.3.1 Once the preferred bidder has been selected, it is important that the Authority manages the process up to financial close well. This is to ensure VFM is optimised through both doing a range of checks before signing off and also looking further ahead by putting in place arrangements for managing the project once the contract has been signed. Evaluation issues at this stage are:

- **The project fits with the business requirements of the Authority**

  The Authority should have ensured that the project strategy and proposed contract reflected its current requirements.

- **PFI is the appropriate delivery mechanism**

  The Authority should have undertaken a review which confirmed that reasonable alternatives to the proposed deal were fairly evaluated and eliminated;

- **Stakeholders support the project's progress**

  Stakeholders should have been kept informed of project progress with key stakeholders signalling their agreement in the final business case. This includes explicit support from any bodies that provide the Authority with a significant stream of income.

- **There is good quality project management**

  Delays in getting to contract close should have been minimised and outstanding contractual issues kept to a minimum. In addition the Authority should have its plans in place for future contract management.

- **There is an optimal balance between cost, quality and flexibility**

  The Authority should have confirmed that it has got the best trade off between quality and affordability, ensuring that the best financing terms available in the market have been reached. There should have been a separate review to confirm that the accounting treatment does not distort the value for money.

- **Effective risk allocation and management is taking place**

  The final agreed risk transfer should have been reviewed for appropriateness and the Authority should have had a risk management plan to address either non-delivery of the planned asset or service delivery failure in the operational phase.

2.4 Pre-Operational Implementation

2.4.1 The value for money indicators for this phase of a project's life-cycle are centred on ensuring that the delivery of the asset is proceeding appropriately and that the Authority is preparing for the start of the operational phase. The priorities at this stage are:

- **The project fits with the business requirements of the Authority**

  The asset[10] should have been delivered to time and quality with any increases in the unitary payment only being caused by inflation uplifts and contract variations.

- **PFI is the appropriate delivery mechanism**

  The baselining of current service performance should be continuing so that the Authority is in a strong position to analyse delivery under the PFI procurement route once the asset becomes fully operational.

- **Stakeholders support the project's progress**

  Stakeholders should have been kept informed of progress in a way that is appropriate to their interest in the project.

- **There is good quality project management**

  The Authority should have been able to resolve any outstanding issues from contract close as well as problems arising during the delivery of a new asset. There should also have been forward planning for the operational phase in relation to new systems, contract management skills and governance arrangements. This is also the optimal time to have learnt lessons from the procurement and its outcome through a post procurement evaluation.

- **There is an optimal balance between cost, quality and flexibility**

  There should have only been agreed increases in the unitary payment where the Authority requested changes to specifications. These changes should have been assessed as good value for money and affordable.

- **Effective risk allocation and management is taking place**

  The risk mitigation procedures should be working properly and the risk management plan should have been updated during this phase.

2.5 Early Operational

2.5.1 We have defined this phase as lasting around three years from the commencement of service with the new asset (or transfer of asset). It reflects our experience of how long it takes before early operational problems are ironed out and a constructive relationship between private and public sectors has been fully developed. The priorities in this phase are:

- **The project fits with the business requirements of the Authority**

  The services should have been delivered to contract based on a performance monitoring system and payment mechanism which are effective. The asset should be fit for purpose and the contractual services should be identified as being in line with the current business requirements.

- **PFI is the appropriate delivery mechanism**

  The Authority should not have to make an assessment as to whether PFI is the appropriate delivery mechanism except where the construction of the asset has resulted in a poor outturn. In those circumstances the Authority should have assessed whether or not it was appropriate to terminate the contract.

- **Stakeholders support the project's progress**

  The Authority should have been checking that stakeholders are satisfied with how the asset and associated services are performing. The Authority should also be taking steps to address concerns raised from canvassing of stakeholders.

- **There is good quality project management**

  The Authority should have a contract management team that has the appropriate skills and knowledge for the operational phase. The governance structures should be used to proper effect and the Authority and contractors should have a good working relationship.

- **There is an optimal balance between cost, quality and flexibility**

  The balance between cost and quality should have been maintained so that both are robust.

- **Effective risk allocation and management is taking place**

  The Authority should have ensured that service related risks transferred under the contract were not passed back to them and that risk management plans are being updated.

10 Or, in some cases, the "handover" of an asset that is to be used by the public sector but maintained by the private sector.

2.6 Mature Operational

2.6.1 As the operational period of the PFI contract progresses, value for money assessment focuses on how well the deal is meeting the Authority's longer term strategic needs. At a simple level, it is asking whether the deal has the flexibility to cope with changes in circumstances that will occur over a period of 25 years or more and still provide value for money. The priorities in this phase are:

- **The Project fits with the business requirements of the Authority**

  The Authority through regular monitoring of contractor's performance should be updating the contract if necessary to meet changing business requirements as well as checking that the asset is maintained and fit for purpose.

- **PFI is the appropriate delivery mechanism**

  The Authority should be assessing whether the PFI deal has benefited the Authority and confirming whether it will remain the best value for money for future service provision.

- **Stakeholders support the project's progress**

  The Authority should be ensuring that stakeholder satisfaction is being maintained.

- **There is good quality project management**

  The Authority should be maintaining good project management skills, an appropriate governance structure and good relationships with the contractor. It should also have made timely steps to plan for the end of the contract.

- **There is an optimal balance between cost, quality and flexibility**

  The trade off between cost and quality should have been maintained. Benchmarking and market testing exercises are one test of this.

- **Effective risk allocation and management is taking place**

  The allocation of risk should remain optimal and the accounting treatment remain consistent with the actual risk transferred to the private sector. Risk management procedures should have been updated to work in line with any changing circumstances.

ANNEX 1

Applying the Matrix: Considerations for Evaluators

1 Strategic Analysis

Theme	Indicators	Further questions
The project fits with the business requirements of the Authority	Has the best form of project to pursue been selected?	Have clear objectives for the project been set? Does the project meet policy imperatives? Was the project assessed as being priority? Has a preliminary evaluation of the benefits sought been made? Has long term commitment to the project been demonstrated? Are the project outcomes clear? Have the project's wider socio-economic benefits been quantified? Does the proposed solution clearly meet business requirements?
	Have top level output specifications for the required services been drawn up?	
PFI is the appropriate delivery mechanism	Has the project been assessed as part of a suitable investment programme for PFI?	
	Has a good outline business case justifying a PFI procurement route been produced?	
	Are the qualitative reasons for proceeding with PFI clearly justified?	Can a viable PFI contract be constructed? ■ Can programme level objectives and outputs be delivered by a PFI contract? ■ Is the Authority satisfied as to the operational flexibility of a PFI contract? ■ Is the Authority satisfied that there are no overriding reasons for providing the service directly? ■ Is the private sector capable of delivering the required outcome?

Theme *(continued)*	**Indicators** *(continued)*	**Further questions** *(continued)*
PFI is the appropriate delivery mechanism *(continued)*	Are the qualitative reasons for proceeding with PFI clearly justified? *(continued)*	Has it been demonstrated that PFI would bring sufficient benefits? ■ Is there sufficient scope for the transfer of risk to a private partner? ■ Is there likely to be scope for innovation? ■ Is the transfer of soft service provision essential for improved service delivery? ■ Can the service be assessed against an agreed standard? ■ Can the PFI payment mechanism incentivise the levels of service provided? ■ Is the service suitable to be managed on the basis of a long term contractual relationship? ■ Is it possible to integrate the design, build and operation of the project? Is a PFI procurement achievable? ■ Is there capability to manage the project and appraise ongoing performance against agreed outputs? ■ Is there likely to be sufficient market appetite for the project?
	Are the quantitative reasons for proceeding with PFI clearly justified?	Is there a comparison between the likely costs of the PFI option and a public sector comparator (PSC)? Are the transaction costs likely to be manageable? Is it based on sound evidence from all types of past procurement experience? Is the overall project affordable? Has sensitivity analysis been undertaken to compute the effect of assumptions on the relative value for money of the procurement routes? Have the possible benefits as well as the costs of delivery options been quantified?
	Has service performance been baselined for future monitoring of PFI contractor performance?	
	Is the optimal project structure for the Authority deemed acceptable for potential private sector partners and funders?	
Stakeholders support the project's progress	Is there a strategy to communicate with stakeholders on an ongoing basis?	
	Have the relevant stakeholder groups been consulted in producing the outline business case?	

Theme *(continued)*	Indicators *(continued)*	Further questions *(continued)*
There is good quality project management	Have the governance structures for the project procurement been set up?	
	Has a realistic project procurement timetable been laid out?	
	Has a well resourced and experienced project team been put in place for the procurement?	Do the project team members have the relevant skills? ■ Is there appropriate legal, technical and financial expertises? ■ Is there appropriate procurement expertise? Has the project team been assembled in good time? Have adequate procedures been put in place for managing the risk associated with staff changes? Has a sufficient amount of staff resource been allocated to the project? Has the authority incorporated lessons learnt from the previous procurements?
	Has the form of staff and user consultation required for the procurement been identified?	
	Has the senior management input required for a successful procurement been identified?	
There is an optimal balance between cost, quality and flexibility	Have market soundings been taken to generate maximum competition?	
	Is the Authority confident that the specification for the project will be affordable?	
	Has the optimal balance of the proposed project not been compromised by favourable accounting treatment for the Authority?	
Effective risk allocation and management is taking place	Has the project risk been fully assessed? Are procurement risks being managed well?	Have the risks associated with the project been identified? Is the proposed risk allocation sensible? Have the risks with proceeding with the project been identified? Has a mitigating risk management plan been put in place and been followed?

2 Tendering

Theme	Indicators	Further questions
The project fits with the business requirements of the Authority	Do the output specifications in the tender properly address the business requirements?	Is the specification detail properly focused on outputs rather than inputs? Is the specification consistent with the expected project deliverables? Were Authority staff appropriately involved in the identification of requirements? Are the output specifications clearly communicated to bidders in the Tendering documents? Did the Authority discuss their requirements with prospective bidders to ensure that they were practical?
	Have robust payment and performance measurement regimes been put in place that clearly reflect optimal business requirements?	Is a robust performance-measurement regime proposed? ■ Are performance measures well defined and objective? ■ Is there an efficient division of responsibility for monitoring performance proposed? Is there a robust payment regime proposed? ■ Does the proposed regime encourage the contractor to deliver the service to the level expected? ■ Is payment dependent on satisfactory delivery of the required services? ■ Are payment deductions proposed for poor delivery of services? ■ Is the payment regime calibrated to focus on the most critical aspects of service delivery?
	Is the Authority clear about its approach on balancing flexibility for change against price?	Do the tender documents include proposed procedures for introducing changes to the Authority's requirements? Has the Authority decided what would be an acceptable cost trade-off for long-term operational flexibility?
PFI is the appropriate delivery mechanism	Has the Authority encouraged the private sector to put forward innovative solutions?	Design Variants? Operational Process Variants? Financing Variants? Output Variants? Risk Transfer Variants?
	Has the Authority checked that the justification for a PFI solution as contained in the business case still holds?	
Stakeholders support the project's progress	Have all key stakeholders maintained commitment to the project?	

Theme *(continued)*	Indicators *(continued)*	Further questions *(continued)*
There is good quality project management	Has a good project team been maintained for the tendering phase?	Is there access to sufficient expertise when required? Are there team members with good negotiating skills?
	Has a clear and realistic timetable for tendering been put in place and maintained?	
	Have likely contract issues been identified before the start of tendering?	
	Have procurement costs been controlled?	Have advisers been appointed after competition? Have realistic budgets been set and updated where appropriate? Have costs been monitored and managed?
	Has a clear process for evaluating bids and setting assessment criteria been put in place?	Have clear assessment criteria been set in advance of tendering and communicated to bidders? Is the weighting of evaluation criteria in line with business objectives? Have specialist sub-groups been set up to evaluate the different components of the bids, e.g. financial, quality of service, financial stability of bidders, risk transfer and design quality? Has the importance of relationships and partnership working been incorporated as an assessment criterion? Is the decision making process transparent? Are clear guidelines for liaising with bidders drawn up?
	Is the Authority clear about the governance arrangements for the project once it is operational?	
There is an optimal balance between cost, quality and flexibility	Have quality bids addressing core business requirements been received?	
	Has the economically most advantageous bid been selected?	Is the cost of the bid affordable? Does the winning bidder have a good track record? Is the proposed design suitable for business requirements? Are the proposed operational solutions suitable for business requirements? Is VFM being achieved without workers' terms and conditions being degraded?
Effective risk allocation and management is taking place	Is the risk best managed by the private sector being transferred as part of the proposed contract?	
	Are the procedures for managing procurement risk working and being updated where applicable?	

3 Contract Completion

Theme	Indicators	Further questions
The project fits with the business requirements of the Authority	Has the project strategy and likely outcome been re-evaluated to ensure they are still in line with business needs?	Are the original objectives for the project still valid? Does the proposed deal fit with the latest circumstances?
	Does the contract reflect the Authority's business requirements?	Does the contract reflect the deal that has been negotiated? Are handover/termination arrangements clearly specified? Are there appropriate sanctions/bonuses to incentivise the contractor? Are the performance measures in line with the business requirements? Are there appropriate provisions for dealing with changing requirements?
PFI is the appropriate delivery mechansim	Was a review carried out to confirm that alternatives were evaluated and fairly eliminated?	Were all reasonable alternatives examined if there was doubt about the value for money of the PFI deal? Was there a clear overview confirming the desirability of proceeding with the best deal?
Stakeholders support the project's progress	Do key stakeholders support the agreed deal?	
There is good quality project management	Has good procurement management been exercised during the preferred bidder stage?	Have the differences between the winning bid and contract award been limited? Were delays in getting to contract close kept to a minimum? Have outstanding issues at contract close been kept to a minimum?
	Are there appropriate contract management arrangements in place?	Have responsibilities for monitoring the contract been established? Has the Authority ensured that key staff monitoring the contract have the required knowledge and skills? Are there appropriate arrangements for feedback from Authority staff interfacing with the project? Are there appropriate processes for resolving day-to-day operational issues?

Theme *(continued)*	Indicators *(continued)*	Further questions *(continued)*
There is an optimal balance between cost, quality and flexibility	Is the deal affordable in the short and long term?	Are there firmly secured sources of funds for any capital injections into the project by the Authority? Are there firmly secured sources of funds for ongoing payments?
	Has competitive financing been achieved?	Has a financing competition been held? Has the optimal finance structure been achieved?
	Is the final agreed deal the economically most advantageous solution?	Has the asset design been assessed as being optimal for users? Have the service specifications been assessed as what is required by service users? Have the benefits and costs of the proposed asset and services been quantified?
	Has a review been conducted to ensure that accounting treatment has not compromised the deal's optimal balance?	
Effective risk allocation and management is taking place	Has the final agreed risk transfer contained in the contract been reviewed for appropriateness?	
	Does the Authority have a risk management plan for use when the contract goes live?	

4 Pre-Operational Implementation

Theme	Indicators	Further questions
The project fits with the business requirements of the Authority	Is the asset being delivered to contractual specification?	Is the asset being delivered to time? Is the asset being delivered to quality? Is there any increase in the unitary payment?
PFI is the appropriate delivery mechanism	Has the baselining of service provision continued?	
Stakeholders support the project's progress	Have key stakeholders been kept informed of project progress?	
There is good quality project management	Has a good post-procurement evaluation been carried out	Has the evaluation considered if the staffing of the procurement was appropriate? Was there evaluation of the use of external advisers? Was there effective planning and management of the procurement? Has the evaluation identified deficiencies in the contract that need to be resolved? Have the lessons from such an evaluation been disseminated for wider learning?
	Are all outstanding issues from contract close resolved? Is there provision for effective oversight and resolution of material problems arising?	Has a clear timetable for resolving such issues been produced? Has a clear project management process been put in place for ensuring the issues are resolved? Has a process been agreed between the Authority and the contractor for resolving problems? Are the appropriate levels of management staff committed to resolution procedures? Does the Authority have a fall-back plan in place if there is a delay to the asset becoming operational?

Theme *(continued)*	Indicators *(continued)*	Further questions *(continued)*
There is good quality project management *(continued)*	Are systems developed to deal with the new asset and service provision?	Has the Authority properly educated its staff on the changes to be expected once the operational phase commences? Do both parties have appropriate procedures for managing the handover period?
	Are the governance arrangements still appropriate?	
	Has the correct skills transfer taken place within the public sector from procurement to operational contract management?	Is there a sensible resource plan to go from delivery to operational phase? Has the Authority put in place procedures for transferring knowledge of the contract from the negotiation team to the contract-management team?
There is an optimal balance between cost, quality and flexibility	Do price increases only relate to new priority changes needed by the public sector, which are on terms that are good value for money?	
Effective risk allocation is taking place	Are risk mitigation procedures working properly?	Is the risk-management plan being updated regularly?

5 Early Operational

Theme	Indicators	Further questions
The project fits with the business requirements of the Authority	Is service provision meeting contractual requirements?	Is the performance-measurement system working properly? ▪ Is the contractor providing timely performance data? ▪ Does the PMS cover all services under the contract? ▪ In terms of their objectivity, are the performance measurement criteria acceptable? ▪ Does the Authority believe that it is receiving accurate performance data? ▪ Are the contractor(s) monitoring performance through a quality-management system? ▪ Is the Authority reviewing the contractor's quality-management system? ▪ Are there procedures for service users to report failures? Is there a functionally effective payment mechanism? ▪ Does the payment mechanism cover all relevant aspects of the Authority's business? ▪ Does the payment reflect the level of service available? ▪ Does the payment mechanism seek to make deductions for substandard performance? ▪ Has the Authority reviewed the impact and appropriateness of contractual incentives?
	Is the asset fit for purpose?	Have construction problems been resolved on a timely basis? Is good maintenance of the asset being carried out?
	Where contractual services differ from business requirements, is the Authority acting to align them?	Has the Authority assessed whether the service levels contained in the contract meet the business requirements? Has the Authority taken steps to resolve the discrepancy?
PFI is the appropriate delivery mechanism	In the event of poor construction outturn, is the Authority sure that maintaining the PFI route for future service provision is the best value for money?	Has the Authority considered termination where poor construction performance has occurred? Has the cost of termination been evaluated? Are alternative service-delivery mechanisms realistic?
Stakeholders support the project's progress	Is there a good level of stakeholder satisfaction?	Has the Authority canvassed and measured stakeholders' satisfaction with contractor performance? ▪ Has the Authority taken steps to address concerns raised by stakeholders? Are end-users satisfied with the level of service from contractors?
There is good quality project management	Are the governance structures being used appropriately?	Are minor problems and issues being addressed and resolved on a timely basis? Are strategic issues and major service-related problems and disputes within the remit of the top tier of the governance arrangements?
	Are the relationships between the Authority and contractors working well?	Are relationships between both parties satisfactory at senior-management level? ▪ Is the contractor kept abreast of the Authority's strategic direction? ▪ Is there an open and honest environment between the contractor and the Authority? ▪ Have both parties developed a single business focus for the project?

Theme *(continued)*	Indicators *(continued)*	Further questions *(continued)*
There is good quality project management *(continued)*	Are the relationships between the Authority and contractors working well? *(continued)*	Are the appropriate relationships in place at the operational level between Authority and contractor staff? ■ Do PFI company staff have an appropriate understanding of the Authority's business? ■ Are relationships being facilitated by co-location of services? ■ Are Authority staff able to easily contact the relevant individuals from the PFI company to discuss issues?
	Does the Authority ensure that the project team have appropriate skills and knowledge for good service provision?	Do contract-management staff have a detailed knowledge of the contract? ■ Do contract-management staff understand their roles and responsibilities? ■ Is there a contract-management manual? Does the Authority have a process of continual learning? ■ Is the Authority regularly evaluating the performance of the contract-management team? ■ Does the Authority make use of external consultants where appropriate? ■ Does the Authority seek to learn from the experience of other PFI projects and other Authorities? Does the Authority have appropriate procedures to deal with loss of staff and knowledge?
There is an optimal balance between cost, quality and flexibility	Is affordability for the deal being maintained?	Are both parties working together to identify cost reductions? Has a refinancing, with a relevant share of gains, taken place where possible? Has the Authority established the process and timing of future benchmarking exercises?
	Are both parties seeking to maximise quality?	Are innovations in service delivery taking place? Are both parties benefiting from two-way working for suggesting improvements to each other's business? Do both parties have a process of continual learning and development in place? Are contractors improving the quality of service where specific failures have been identified?
Effective risk allocation and management is taking place	Has the allocation of risks been sustained operationally?	
	Are the risk implications of changes to the contract consistent with the risk that was originally transferred?	
	Are the Authority's risk-management procedures updated and working in line with changing circumstances?	

6 Mature Operational

Theme	Indicators	Further questions
The project fits with the business requirements of the Authority	Is service provision outturn meeting core business requirements?	Has the Authority identified where contractual service levels do not meet business requirements? Has the Authority taken steps to rectify the difference between business operational requirements and performance levels? a Are the standards of service provision in the contract being updated to reflect core business requirements? b Is subsequent service provision meeting the revised SLA? ■ Does the Authority ensure that the information generated by the performance monitoring system is consistent with any update or change to the contract? ■ Is the contractor meeting revised service requirements? ■ Is the Authority reviewing the impact and appropriateness of the revised contractual incentives?
	Is the asset still fit for purpose and maintained to a good standard?	Is the asset in a fit state for use? Has the asset's fitness for purpose been assessed? Are maintenance schedules being adhered to? Is the Authority checking that the SPV's maintenance reserves are being managed to ensure sufficient monies are available for asset replacement and maintenance?
PFI is the appropriate delivery mechanism	Has the Authority improved its performance since the PFI project became operational?	Has service provision (both PFI-delivered and that retained in-house) been compared to the previously baselined service provision? Have the outcomes identified as PFI-specific in the business case been realised? Has the PFI asset's design outcome been assessed in a qualitative comparison with equivalent non-PFI assets?
	Has the Authority assessed whether maintaining the PFI deal for future service provision is the best value for money?	Has the Authority considered termination where poor performance is occurring? Has the cost of termination been evaluated? Are alternative service-delivery mechanisms realistic?
Stakeholders support the project's progress	Is a good level of stakeholder satisfaction being maintained?	Is the Authority periodically canvassing stakeholders for their views on the how the asset and associated services are performing? Is the Authority taking steps to address concerns raised by stakeholders? Is there ongoing end-user satisfaction with the level of service from contractors?

Theme *(continued)*	Indicators *(continued)*	Further questions *(continued)*
There is good quality project management	Are the governance arrangements still appropriate?	Have governance structures been reviewed and updated with changing circumstances? Are disputes over service provision being resolved at the appropriate management levels? ■ Are minor problems and issues being addressed and resolved by the lower tiers within the governance structure? ■ Is the Authority using the top tier of the governance structure to discuss contract change, service improvement, business development and strategic direction, and to resolve major problems and disputes?
	Are good and constructive relationships between both parties being maintained?	Are relationships between both parties satisfactory at senior management level? ■ Are the appropriate relationships being created according to changing circumstances? ■ Is the contractor consulted over the Authority's strategic direction? ■ Is there an open and honest environment between the contractor and the Authority? ■ Is a single business focus for the project being maintained by both parties? Are the appropriate relationships in place at the operational level between the Authority and contractor staff? ■ Does the PFI company staff have an appropriate understanding of the Authority's business? ■ Are relationships being facilitated by co-location of services? ■ Is the Authority able to easily contact the relevant individuals from the PFI company to discuss issues?
	Is the Authority taking steps to ensure that the project team continues to have the appropriate skills and knowledge for good service provision?	Is the Authority re-evaluating skills sets for the management of the project to ensure appropriate staff are in post? Do contract-management staff have a detailed knowledge of the contract? ■ Do contract-management staff understand their roles and responsibilities? ■ Is the contract-management manual being updated? Does the Authority have a process of continual learning? ■ Does the Authority regularly evaluate the performance of the contract-management team? ■ Does the Authority make use of external consultants where appropriate? ■ Does the Authority seek to learn from the experience of other PFI projects and other Authorities? ■ Does the Authority have appropriate procedures to deal with loss of staff and knowledge?
	Has the Authority taken steps to plan for the end of the contract?	Has the Authority identified how services will be provided once the contract finishes? Has the Authority identified the risks associated with the handover of the asset at the end of the contract?

Theme *(continued)*	Indicators *(continued)*	Further questions *(continued)*
There is an optimal balance between cost, quality and flexibility	Is affordability being maintained?	Are both parties actively seeking cost reductions? Is the Authority ensuring that the cost of changes to service provision are reasonable?
	Are both parties seeking to maximise quality?	Are innovations in service delivery taking place? Are both parties benefiting from two-way working for suggesting improvements to each other's business? Do both parties have in place a process of continual learning and development? Are contractors improving the quality of service where specific failures have been identified?
	Is periodic benchmarking for price and quality taking place?	Have appropriate benchmarks been identified? Is the period of time between benchmarking exercises appropriate?
Effective risk allocation and management is taking place	Is the Authority satisfied that the risk transferred remains optimal?	Is the risk deemed as being transferred to the contractors consistent with the risk that is being borne by the contractor in practice? Has the formal allocation of risks been reviewed? Are the risk implications of changes to the contract consistent with optimal allocation of risk?
	Are the Authority's risk-management procedures updated and working in line with changing circumstances?	
	Does the accounting treatment for the asset remain consistent with the actual risk that has been transferred to the private sector?	

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