National Audit Office

REVIEW

Option Appraisal: Making informed decisions in government

Informed Government

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Summary

Introduction

1 An informed government collects high quality information on context, activities and results; analyses it to expose issues or opportunities; and presents informed options to decision-makers internally, and candid assessments of plans and performance externally. Without high quality information government will not be well placed to respond to the immediate challenge of cuts to funding and longer-term challenges of providing sustainable high-quality public services and creating the right climate for economic growth.

2 Option appraisal is crucial to ensure government interventions are fully informed and based on robust evidence. The core method of economic appraisal, cost-benefit analysis, has been designed to inform comparison between options for government interventions, recognising that in the public sector appraisals need to go beyond traditional financial analysis, and pick up broader social, environmental and economic effects which may not have ready market values. Appraisal techniques can be applied at project or programme levels, and have particular value when there is pressure to reduce costs while minimising effects on front line services or the wider economy.

3 There are two primary option appraisal processes in government: business cases and Impact Assessments. Generally, the former deals with expenditure, and the latter with policy impacts and regulatory burdens. They follow similar, but not the same, processes and both are based on the principles set out in government's central guidance on appraisal, the Green Book (see **Figure 1**).

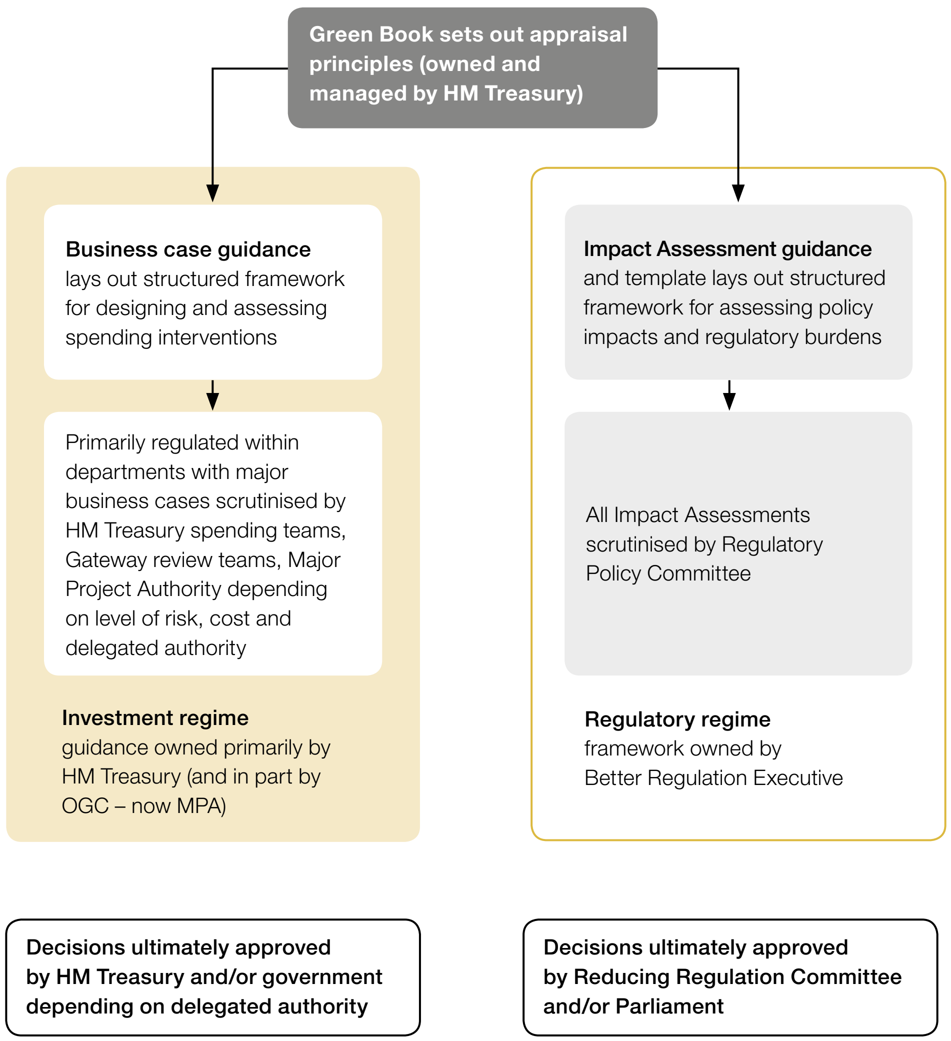
The National Audit Office's review of option appraisal

4 We have regularly concluded in our value for money reports that departments could either not demonstrate the value for money of government interventions or that interventions provided poor value for money due to an absence of option appraisals. For example, in our report on *Reorganising Central Government* we concluded that the value for money of central government reorganisations could not be demonstrated because, among other concerns, "three-fifths of arm's length bodies did not conduct investment appraisals to compare expected costs and benefits of alternative options before taking a decision to reorganise".[1] In our report on the *Coal Health Compensation Schemes* we concluded that the scheme provided poor VFM for the Department of Trade and Industry because it "set out the pay compensation without a systematic in-depth option appraisal being considered at more senior levels within the Department".[2] We have also reviewed Impact Assessments annually since 2002[3] and our most recent report (July 2010) found that the quality of Impact Assessments had improved but remained variable.[4]

5 This inconsistency in appraisal prompted us to review a broader set of recent appraisals, and seek views on the appraisal process from Chief Economists and their staff, and from policy and finance officials. Our methodology is presented in Appendix One. This report is aimed at staff involved in option appraisal at working level or responsible for options appraisal within a department. There are specific findings which will be of interest to the Treasury and Better Regulation Executive as they revise guidance for option appraisal across government.

1 Comptroller and Auditor General, *Reorganising Central Government,* HC 452, National Audit Office, March 2010, paragraphs 7 and 10.
2 Comptroller and Auditor General, *Coal Health Compensation Schemes,* HC 608, National Audit Office, July 2007, paragraph 9.
3 http://www.nao.org.uk/areas_of_specialist_expertise/regulation/about_regulation.aspx
4 *Assessing the Impact of Proposed New Policies,* HC 185, National Audit Office, July 2010, paragraph 6.

Figure 1
The current option appraisal landscape



Source: National Audit Office

Key findings

Established systems for option appraisal seek to promote good decision-making

6 Central guidance on cost-benefit analysis is thorough, and there are established systems to make sure that policy, regulation and expenditure projects are appraised. Many departments supplemented central guidance with material relevant to their sector. Most staff we consulted understood the need for appraisal, and the main administrative routes that they had to follow. Structural developments, such as the creation of the Regulatory Policy Committee, and in some departments, Investment Committees, had tended to emphasise the importance of good appraisal. Significant failures to implement appraisal guidance or take account of policy commitments can result in judicial reviews.[5]

7 The quality of the appraisals we reviewed varied and the findings below highlight the need to sharpen the requirements for completing appraisals, and tighten management of its application, to secure full value from the process. While we judged 23 of 53 cost-benefit analyses presented in the appraisals we reviewed to be good or better, 30 contained weaknesses. We did not find any significant link between the size of a project and the quality of appraisal. Others have also noted problems with appraisals; for example, a recent review of 189 Impact Assessments by the Regulatory Policy Committee judged 44 per cent of appraisals not fit for purpose.[6] The main weaknesses we found were:

- Inadequate development of options against which to judge the preferred course of action;
- Lack of monetisation of burdens and benefits – over 40 per cent of those involved in the appraisal process we surveyed did not agree that sufficient time and effort went into monetising impacts;
- Unstructured qualitative analysis – while qualitative arguments were influential in a large proportion of cases, few followed guidance on ways to structure that analysis, or applied a qualitative structure consistently to all options considered.

8 Staff perceived business cases to be more relevant to decisions than Impact Assessments. They told us that this was partly because Impact Assessment requires standard processes to be applied to all policies, regardless of their potential size or impact, and was therefore very inflexible. Business cases, by contrast, were subject to a series of delegations graded by financial size and risk, and associated differences in the level of scrutiny. Both processes, however, provide for the depth of analysis to be 'proportionate' to the significance of the decision. The challenge has been to define 'proportionate' logically and in a well-informed way: the central guidance does not cover this issue well.

Management of the appraisal processes by departments

9 Good planning helps to integrate appraisals into the decision-making process. Many departments had no standard process across their organisation to manage the development of Impact Assessments, but those that had such a process produced, on average, stronger appraisals. When regulation and spending were required within the same intervention the best departments had integrated the Impact Assessment and business case process together. The adoption of a 'one in one out' policy on regulation, and the advent of Investment Committees or similar governance structures for expenditure, is stimulating further attention to the scheduling of new policies and programmes. Good planning draws on such scheduling and helps assign suitable appraisal resources and promotes a better programmatic overview – we noted that better appraisals built in consideration of prior interventions in that policy area.

10 Quality assurance processes are well established across government but they do not guarantee appraisal quality. Often, departments operate a review process during the appraisal cycle and we found early involvement of analytical staff in the appraisal improves the quality of appraisals. Most Impact Assessments are signed off by Chief Economists, while there is a graded sign-off process for business cases based on delegated authority limits. We found that departments have different assurance processes and there was no management information resulting on the initial quality of appraisals.

5 This includes, for example, the High Court judgement in March 2010 that the Government's decision to give a green light to the proposed third runway at Heathrow contained out-dated figures and had not properly taken into consideration the Government's own climate change policy.

6 See *Challenging Regulation*: *An independent report on the analysis supporting regulatory proposals September-December 2010,* Regulatory Policy Committee, February 2011.

One of the departments retrospectively reviews the quality of appraisals on a sample basis, a process which has been influential in securing a trend for increased quality over several years.

11 Over many years, the NAO has found that business cases or Impact Assessments, once produced, have not been used to manage the delivery of benefits and manage costs against original expectations. We have found that departments have few systematic checks between appraisal costs and benefits estimates, and associated project or programme monitoring. Our previous work has highlighted a lack of post-implementation reviews or evaluations and the department staff we surveyed thought that insufficient review occurs. Changes have been made to regulatory processes to incentivise reviews, but it is too early to judge their success.[7]

12 There are differences between the two appraisal systems in the timing, the precise analyses required, the format of appraisal documents and the delegation arrangements. Such differences reflect the historical development of regulation and expenditure control as much as any intrinsic difference in appraisal requirements. While Impact Assessment requires consultation and then external, independent scrutiny of appraisals by the Regulatory Policy Committee, there are no equivalent requirements for business cases. Larger business cases may be scrutinised by HM Treasury spending teams depending on departments' delegated authority limits. We found that strong external challenge and transparency were motivators for staff to improve the quality of appraisal.

13 Staff we interviewed and surveyed did not have a full appreciation of existing guidance and requirements. For example, many of the Specific Impact Tests are not widely used or understood by most officials involved in the process. Unnecessary differences between appraisal processes will incur extra cost in maintaining guidance, training staff and enforcing compliance and likely reduce the quality of appraisals overall.

Conclusions and areas for improvement

14 The previous findings show there is scope to improve the quality of appraisals in a proportionate way, and increase their contribution to more cost-effective outcomes. We identify below some principles for improvement, covering incentives and behaviours as well as technical issues.

15 The way that systems and incentives reinforce good appraisal are important in securing high quality appraisal. Changes are necessary to counter the extent of low quality and respond to staff perceptions of low value. Improvements could be driven by:

- extending publication and external oversight of economic appraisals from Impact Assessments to business cases (where commercial sensitivities allow); increased scrutiny would add pressure to improve quality and is coherent with the transparency agenda;
- departments adopting more structured quality assurance arrangements which could yield useful management information on appraisal quality and reinforce compliance with appraisal standards;
- introducing a proportionate process to limit Impact Assessment effort on low value appraisal would help focus effort where it is needed, and improve attitudes to Impact Assessment;
- checking that the cost and benefit information in appraisals is used – where appropriate by programme and project teams, departmental investment committees and HM Treasury – as a basis for monitoring and managing the implementation of government interventions; and
- creating proportionate measures to mandate evaluation or follow-up, in the way that sunset clauses are intended to operate for regulation, would contribute to better appraisal as well as tauter programme management; HM Treasury could consider, for example, to require programmes above delegated limits to be reapproved based on whether they have demonstrated their value for money through scheduled evaluations.

7 Comptroller and Auditor General, *Delivering Regulatory Reform,* HC 758, National Audit Office, February 2011.

16 Central guidance on appraisal is generally thorough but there are a few areas where a fix is necessary to support better appraisal:

- Clearer specification of what 'proportionate' appraisal effort means for option development, monetisation, and portfolio management. The specification should provide clear advice on areas where there is less discretion due to absolute limits (such as environmental or carbon limits).
- Improving levels of monetisation by promoting their use and promulgate good practice, for example, by extending libraries of techniques and cross-departmental contacts.
- Introducing a requirement for a structured consideration of qualitative factors on a common basis with quantitative analysis which is consistently applied across options, and extending associated practical guidance.
- Developing a requirement to create an explicit 'logic model', setting out the contributions of all factors to the subject of the appraisal, allowing the contribution of qualitative factors to be set in context.

17 Appraisal elements of business cases and Impact Assessment both derive from the Green Book: differences in approach driven by different decision-making contexts have obscured underlying common purpose. We look to the Treasury, the Better Regulation Executive and departments to:

- bring business cases and Impact Assessment processes together where they share a common purpose (e.g. in economic appraisal);
- align processes in areas where each has strengths the other should learn from (e.g. consideration of risk in business cases; transparency and challenge in Impact Assessment);
- bring together design of the business case and Impact Assessment processes to ensure consistent process design;

and longer term they should:

- integrate the oversight and management of the economic element of business case and Impact Assessment processes to support consistent decision-making and a standardised approach.

Part One

Introduction to option appraisal in government

1.1 The development and appraisal of decisions within government is carried out through a range of different methods and techniques. There are, however, two main appraisal processes, Impact Assessments and business cases, and presently they follow many of the same principles and rely on similar techniques.

The option appraisal process

1.2 The main guidance on options appraisal is contained within HM Treasury's Green Book which sets out a framework for the appraisal and evaluation of all programmes and projects. This guidance is supplemented by specific business case and Impact Assessment guidance, in which the interdependence of each process is outlined. Individually departments often develop their own guidance which takes into account the application of the appraisal processes in their domain.

Impact Assessment Process

1.3 Impact Assessments assess the need for, and likely impact of, proposed government policies. They help policy makers think through and understand the consequences of proposed policy interventions; and enable government to weigh and present publicly the relevant evidence on the likely impacts of such interventions. Impact Assessments are required for all government interventions which affect the private sector and for interventions with costs of over £5 million affecting the public sector, including UK implementation of European Union directives and rulings.

1.4 **Figure 2** overleaf outlines the key stages in the Impact Assessment process as set out by the Better Regulation Executive.

1.5 Production of the Impact Assessment is often led within departments by the Policy lead with analytical support coming from economists. The Impact Assessment guidance and templates are maintained by the Better Regulation Executive which is part of the Department for Business, Innovation and Skills. The Better Regulation Executive takes the leads in the delivery of the regulatory reform agenda of which the Impact Assessment is one of their primary tools. Delivery of the Impact Assessment is the responsibility of the individual department.

1.6 Impact Assessments are intended to be used within a cycle of policy development, implementation and evaluation. As part of this process the Regulatory Policy Committee, established in 2010, started with selective reviews of Impact Assessments. The Regulatory Policy Committee is a non-departmental public body tasked with providing independent scrutiny of proposed regulatory measures put forward by government. The coalition Government has extended the Regulatory Policy Committee's remit to all Impact Assessments and the intention is for Ministers to receive an independent view on whether there is sufficient evidence and analysis to support a new regulation. The coalition also introduced a new cabinet sub-committee, the Reducing Regulation Committee, which has the power to send proposed policies back to departments before new regulations are introduced if they have not adequately considered options.

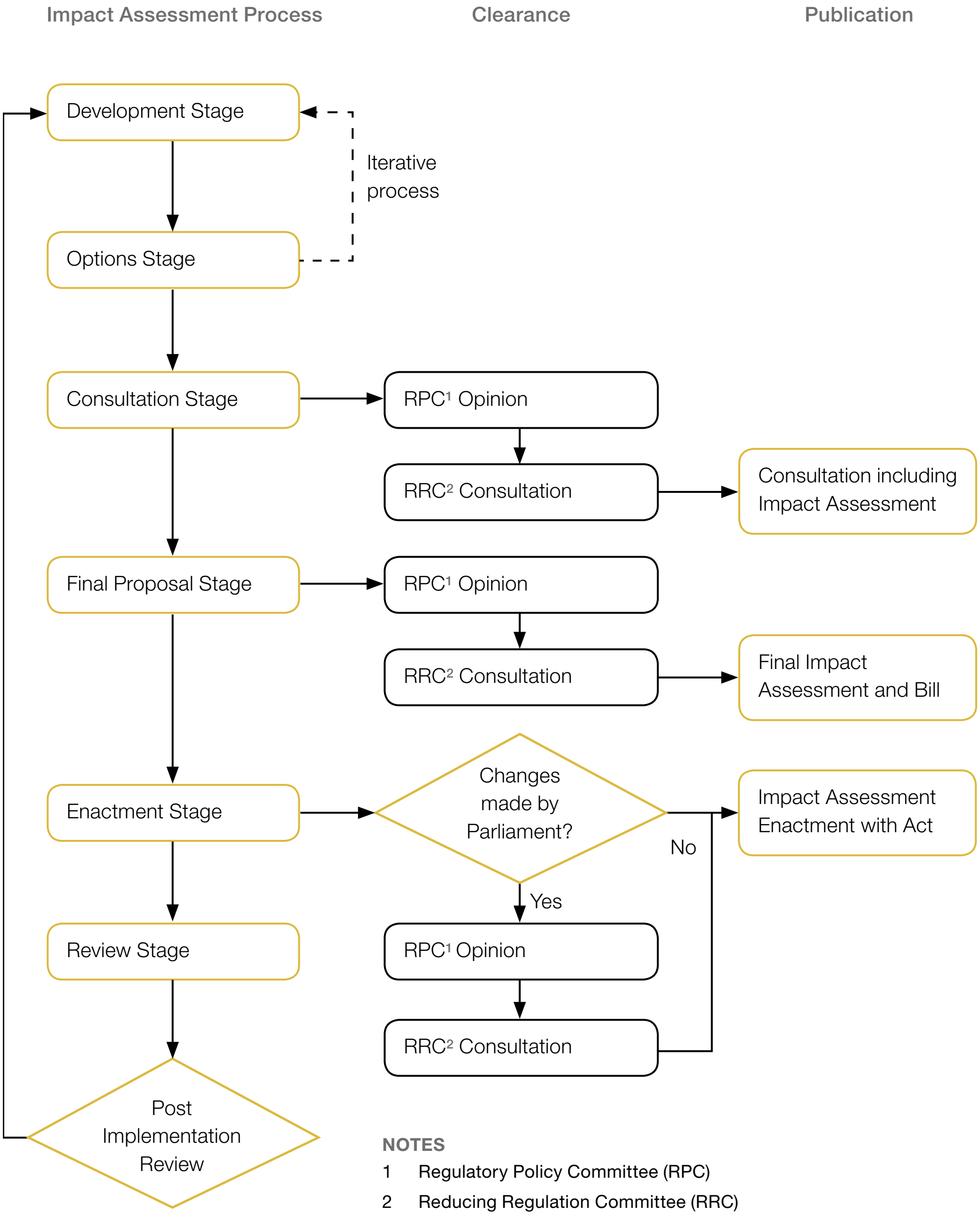
Business Case Process

1.7 The business case process is set out in **Figure 3** on page 11 and the process depends on the cost and risk of the investment: high value and high risk projects receive increased levels of scrutiny and assurance. In contrast to Impact Assessments most business cases are not externally scrutinised and individual departments have investment committees which often serve as the scrutiny and approval mechanism for business case below the delegated authority limit. Departments can choose to invite Gateway review teams to provide assurance at all stages of the project.[8] Selected high risk projects might in addition also be scrutinised by the Major Project Review Group.[9] Key Cabinet Committees also review major policies and occasionally their related business cases. This gives government ministers an opportunity to discuss and check whether wider issues, such as environmental issues, have been appropriately addressed.

8 From 1 April 2011 external assurance will be provided by the Major Projects Authority, while internal review teams will be provided by departments.

9 For more information on the assurance of high risk projects see our report *Assurance for High Risk Projects*, National Audit Office, June 2010.

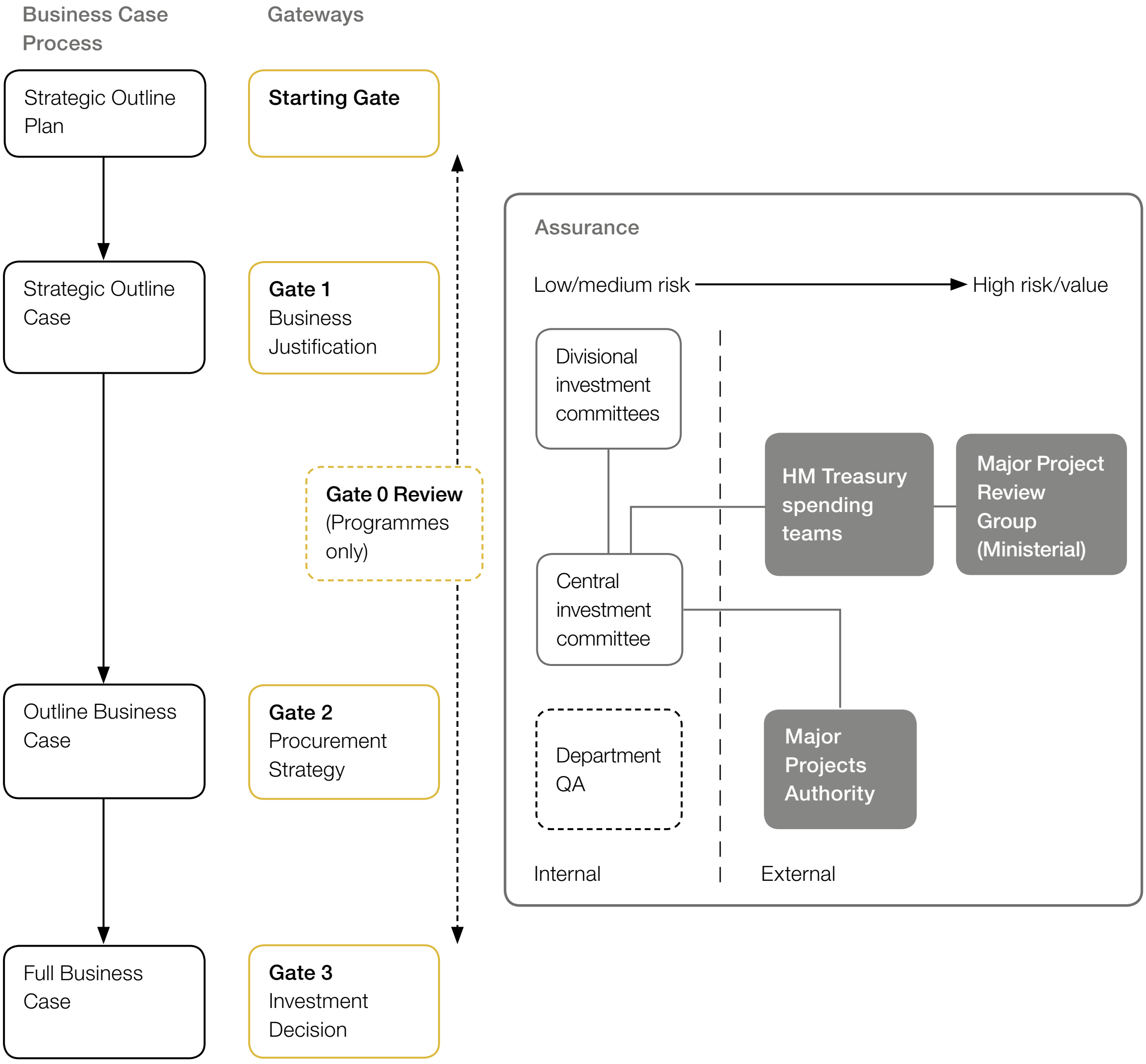
Figure 2
Impact Assessment Flow Chart



NOTES
1 Regulatory Policy Committee (RPC)
2 Reducing Regulation Committee (RRC)

Source: National Audit Office summary of Better Regulation Executive's Impact Assessment Guidance

Figure 3
Business case cycle



Source: HM Treasury Business Case Model and National Audit Office

1.8 HM Treasury play a crucial role in the business case process by:

- setting the delegated authority limits and rules, which lay out which business cases can be approved by departments;
- scrutinising and challenging departments on business cases of high value and high risk projects that exceed departments' delegated spending limits;
- overseeing the internal processes and capacity of departments to assess business cases within their delegated authority; and
- encouraging departments to bring together evidence on cost-effectiveness, including from their option appraisals, across their total spend as part of the Spending Review Process. During the Spending Review 2010 HM Treasury asked, for example, departments to rank and allocate their capital spend using benefit-cost ratios.

Evaluation

1.9 As well as guidance on options appraisal there is also central guidance on evaluation called the Magenta Book. The provision of guidance on evaluation is important as evaluation should feed into appraisal for learning and development and re-evaluating the evidence base. Evaluation should also be used to ensure that objectives are not only delivered but delivered cost-effectively.[10]

10 The Magenta Book has recently been revised to improve its alignment with the Green Book.

Part Two

Quality of option appraisal

2.1 An informed government not only needs the technical details of the costs and benefits to be accurate in the appraisal but for these to be presented in a manner that facilitates decision-making. This section presents our findings on the quality of option appraisal across government and highlights the issues that affect the quality of appraisals from a technical viewpoint and how appraisals are presented.

Overall judgement on option appraisal

2.2 Over a number of years we have found that option appraisals vary in quality within and between departments across government. This finding is supported by the Regulatory Policy Committee's review of Impact Assessments which judged that 44 per cent of new regulatory proposals that they had reviewed between September and December 2010 were not fit for purpose. We have found that the variation in quality applies equally to Impact Assessments and business cases and the quality of appraisal did not correlate with the cost or net benefits of the appraisal. The main issues affecting quality included the lack of option development, inadequate monetisation, and unstructured qualitative discussion.

Option development

2.3 The primary purpose of option appraisal is to help develop a value for money solution for a stated government objective by making fair comparisons of different options. Over many years, through our value for money work, we have identified that the lack of option development can often lead to poor value for money. In our 2010 report on the *Procurement of the M25 Private Finance Contract* we concluded, for example, that the Highways Agency "could have achieved a materially better value for money outcome" by keeping hard shoulder running as a serious alternative option to the preferred widening of the M25.[11]

2.4 Our assessment of the option development in Impact Assessments and business cases for this current review found that lack of option development continues to be an issue for government. We found that only 12 of 45 final Impact Assessments presented a fully monetised alternative to the preferred option.

2.5 During our work policy analysts and economists explained that the lack of development of options could be because the final Impact Assessment does not always contain all the option analysis that has been undertaken in the Impact Assessment process due to its focus on the preferred option. We therefore analysed the option development for a sample of 24 Impact Assessments undertaken before and up to the consultation stage. As **Figure 4** shows, we found that only 12 had fully monetised more than one option. Thus, option development is also limited for those stages of the Impact Assessment cycle which should have a direct impact on policy choices.

Figure 4
Option development up to Impact Assessment consultation stage

	Number	Percentage
No or only preferred option monetised	12	50
Preferred and alternative option monetised	7	29
Preferred, alternative option(s) and 'do nothing/minimum' option monetised	2	8
No appraisals performed before final Impact Assessment	3	13
Total	**24**	

Source: National Audit Office analysis

11 In this case the Department did not accept that hard shoulder running was simply a lower cost solution, but was one that offered materially lower benefits for the reduced cost. Ministers deliberately chose to provide higher benefits and pay the higher costs given the M25's strategic importance. (Comptroller and Auditor General, *Procurement of the M25 Private Finance Contract*, HC 566, November 2010, paragraphs 23 and 24).

2.6 Our review also raises the same issues about the creation of options for spending decisions. Two out of the eight business cases we reviewed only contained one monetised option. In addition, we found minor flaws with the option development of a further two business cases, either because promising options were discarded too early without adequate rationale or because options were presented to decision-makers that were clearly not viable given the objectives of the government intervention. However, we also saw examples of business cases where four viable options were substantially monetised, including the 'do nothing/minimum' option.

2.7 A particular gap in the option development process is the monetisation of the 'do nothing/minimum' option. Both the Green Book and the Impact Assessment toolkit mandate that the final short-list of options contains the 'do nothing/minimum' option and gives decision-makers a baseline against which to judge the relative net impact of other options.[12] Only five of the 45 final Impact Assessments we reviewed monetised either the costs or benefits of the 'do nothing/minimum' option. Monetisation of the 'do nothing/minimum' levels was more common in our business case sample (four out of eight), which dealt with large scale government interventions.

2.8 In our interviews, Chief Economists acknowledged that departments often consider a narrow range of options and noted that promising options are often dismissed too early or discarded options not revisited when a change in scope would again make them viable. They explained that a lack of option development is common in circumstances where ministerial decisions have limited the number of practical solutions. However, as one Chief Economist noted, even when the option choice is narrowed by ministerial decisions, there is usually room for considering different implementation routes.

2.9 Finally, our work suggests that option development can be positively influenced by the early involvement of economists who bring known evidence to the formulation of rationale and setting the scene for framing of options. Our in-depth review of the appraisal process behind 24 final Impact Assessments shows that high quality final Impact Assessments are characterised by the use of a wide range of staff from the beginning of the appraisal process. However, our survey indicates that many economists believe they do not have sufficient involvement to influence development of options (see **Figure 5**).

Figure 5

Economists responses to the statement 'I generally have sufficient involvement to influence development of options'

	Impact Assessments		Business Cases	
	Number	Percentage	Number	Percentage
Strongly agree	7	10	5	13
Agree	21	30	10	26
Disagree	26	37	14	37
Strongly Disagree	12	17	4	11
Neither Agree or Disagree	4	6	5	13
Total	**70**		**38**	

Source: National Audit Office analysis

12 *The Green Book: Appraisal and Evaluation in Central Government,* HM Treasury, 2003, p. 19.; *Impact Assessment Toolkit: A guide to undertaking an Impact Assessment and completing the IA template*, Department for Business, Innovation and Skills, April 2010, p. 19.

Quality of cost-benefit analysis and levels of monetisation

2.10 Cost-benefit analysis is the core option appraisal technique recommended by the Green Book guidance. The influence of appraisals on decision-making relies on the structured presentation of costs and benefits on comparable terms which means in most cases, by expressing in monetary terms. In addition, identifying and monetising significant costs and benefits helps manage budgets across programmes. Quantifying benefits in this way can be difficult and both the Green Book and the Impact Assessment guidance emphasise that the resources used to make this kind of quantification needs to be balanced against the importance and scale of the decision.[13]

2.11 In our review we found that whilst many appraisals did not have flaws (23 out of 53) there were 12 appraisals which contained inadequate levels of monetisation or major technical flaws, such as an unjustified choice of different discount rate or the wrong calculation of transfer payments (see **Figure 6**).

2.12 The survey responses of departmental staff involved in the appraisal process indicated that they thought the quality of monetisation could be improved. As **Figure 7** overleaf shows, while the majority of respondents believe that the monetisation of option is usually based on sound analysis with robust assumptions, there is a sizeable minority that have reservations about the quality of the cost-benefit analysis. This is noteworthy as the analysts who responded to the survey contribute significantly to appraisals.

2.13 Many appraisals monetise only the direct costs to the public purse, and impacts on the primary subject of the intervention. All of the Chief Economists we interviewed commented on the difficulty of measuring wider social, economic, or environmental impacts. Chief Economists noted that the barriers to monetisation lie in a lack of data and reliable monetisation models as well as the often disproportionate costs to collect evidence. As **Figure 8** overleaf shows our survey respondents also expressed reservation about the time and effort that goes into monetising wider, non-market impacts with marginally more respondents disagreeing than agreeing with the statement that sufficient time and effort usually goes into monetising non-market impacts.

Figure 6
Quality of cost-benefit analysis

	Impact Assessments		Business Cases	
	Number	Percentage	Number	Percentage
Analysis had no technical flaws, adequate levels of monetisation and used innovative methods to monetise non-market costs	2	4	0	0
Analysis had no technical flaws and adequate levels of monetisation	18	40	3	38
Analysis had minor flaws and adequate levels of monetisation	16	36	2	25
Analysis had major flaws and/or inadequate levels of monetisation	9	20	3	38
Total	**45**		**8**	

NOTE
1 Figures do not add up to 100 per cent due to rounding.

Source: National Audit Office analysis

13 *Impact Assessment Guidance,* Department for Business, Innovation and Skills, December 2010, p. 4; *The Green Book,* HM Treasury, 2003, p. 19.

Figure 7
Survey response to the statement 'The monetisation of costs and benefits is usually based on sound analysis with robust assumptions'

	Impact Assessment		Business Cases	
	Number	Percentage	Number	Percentage
Strongly Agree	9	10	4	8
Agree	47	51	23	45
Disagree	19	21	13	26
Strongly Disagree	3	3	1	2
Neither Agree nor Disagree	14	15	10	20
Total	**92**		**51**	

NOTE
1 Figures do not add up to 100 per cent due to rounding.

Source: National Audit Office analysis

Figure 8
Survey response to the statement 'Sufficient time and effort usually goes into monetising non-market impacts'

	Impact Assessment		Business Cases	
	Number	Percentage	Number	Percentage
Strongly Agree	4	4	2	4
Agree	34	37	18	35
Disagree	32	35	21	41
Strongly Disagree	8	9	2	4
Neither Agree nor Disagree	13	14	8	16
Total	**91**		**51**	

NOTE
1 Figures do not add up to 100 per cent due to rounding.

Source: National Audit Office analysis

2.14 Our review suggests that the economist community is aware of the issue and is looking to bridge the current monetisation gaps. We found that at least three departments have initiated specific projects that look at how to close gaps both with the available evidence and models. In addition to individual departments' efforts, cross-departmental work groups, such as the Social Impact Taskforce and work on sustainability by the Government Economic Service, should promote increased levels of monetisation in the future.

2.15 There is an opportunity to promote cross-departmental learning by using the HM Treasury's appraisal website as well as the Better Regulation Executive Impact Assessment library as a place to share techniques and guidance on appraisals. This should in the long run allow practitioners to refer to a larger sample of monetised impacts and transfer them to their own appraisals. In general, the Green Book should emphasise more strongly the case for monetisation, making sure that appraisal work is seen as a contribution to the management of a department as a whole, as well as the basis for specific decisions.

Qualitative assessment of options

2.16 Inevitably, there will be some government interventions which will always be too difficult to quantify in money terms and will need to be discussed in other comparable ways. The current Green Book mentions two techniques which can be used to compare unvalued costs and benefits (multi-criteria decision analysis and critical success factors analysis). Incorporating wider, non-monetised issues in the policy appraisal not only ensures that the full range of impacts are appraised, but also encourages policy-makers to consider how non-monetised issues, such as environmental limits, statutory policy targets or regulatory requirements, can be built into options as a positive feature.

2.17 Qualitative factors are often a key element in decision-making. From 45 final Impact Assessments 31 presented a fully monetised preferred option. The remaining Impact Assessments had either monetised only costs or benefits or not monetised any impacts. Out of the 31 Impact Assessments that had provided a net present value eight had either zero or negative net present values. Thus, the preferred option was in only 23 out of 45 cases supported by quantitative cost-benefit analysis. In the remaining cases qualitative reasoning was a decisive factor.

2.18 We found the individual discussion of specific non-monetised costs and benefits appropriate in 26 of 45 final Impact Assessments: in 19 cases either significant non-monetised costs or benefits have not been discussed or we considered the discussion as a whole was inadequate. More generally, we found little evidence of a systemic, structured discussion in our Impact Assessment sample set: while the Green Book recommends multi-criteria decision analysis and critical success factors analysis, we found few Impact Assessments used such techniques. The lack of structured discussions of non-monetised factors in Impact Assessments can partly be explained by the fact that the Impact Assessment template gives little room for discussion of non-monetised factors.

2.19 Qualitative analysis was handled better in the business cases we reviewed: we found four examples in eight business cases that contained a systematic, structured discussion of non-monetised benefits. This may be explained by the emphasis in standard project/programme management techniques often applied to large expenditure projects on monitoring benefit realisation – without structured attempts to specify benefits, realisation is generally difficult to monitor. It could also be explained by more resources being used in developing appraisals for larger projects of this type.

Good practice example
Structuring qualitative assessments

One of the business cases in our sample isolated ten non-monetised benefits and assessed to what extent the various options would realise the benefits either fully, to a large extent, to a low extent, or not at all. The analysis was presented in a table allowing decision-makers to easily compare the non-monetised benefits of the various options. The reasoning behind the assessments was laid out in a separate annex which decision-makers could consult if they wished to understand the rationale for the scoring.

2.20 One of the ways to improve discussion of non-monetised factors is to be more specific in central guidelines as to what is expected from qualitative discussions.[14] HM Treasury and the Better Regulation Executive could therefore usefully promote a more structured approach to its conduct and presentation in the Green Book and the Impact Assessment guidance. This could cover:

- agreement between HM Treasury and the Better Regulation Executive on the creation of an explicit 'logic model', setting out the contributions of all factors to the subject of the appraisal, allowing the contribution of qualitative factors to be set in context;
- clear definitions of the factors to be analysed qualitatively;
- consideration of their 'value function' – e.g. diminishing returns, range limited, stepped vs continuous;
- consistent application of logic on cost and value to both quantitative and qualitative analyses across all options; and
- fair and balanced combination of quantitative and qualitative analyses in the decision process – including explicit identification of the minimum implied value of a qualitative factor, where that has been crucial to the decision.

2.21 **Figure 9** shows that most staff we surveyed who are involved in appraisal believe that non-monetised costs and benefits are currently adequately analysed. If this analysis does occur it was not readily identifiable in the appraisal documents we reviewed. Chief Economists need to raise awareness of the guidance on qualitative analysis, make sure they use already existing qualitative discussion frameworks, and reinforce understanding of the significance of qualitative analysis for decisions.

Figure 9

Survey responses to the statement 'Qualitative costs and benefits that cannot be monetised are, in general, adequately discussed'

	Impact Assessment		Business Cases	
	Number	Percentage	Number	Percentage
Strongly Agree	11	12	2	4
Agree	57	63	37	73
Disagree	11	12	8	16
Strongly Disagree	5	6	2	4
Neither Agree nor Disagree	7	8	2	4
Total	**91**		**51**	

NOTE
1 Figures do not add up to 100 per cent due to rounding.

Source: National Audit Office analysis

14 For example, the Department for Environment, Food and Rural Affairs publish supplementary appraisal guidance on the evaluation of environmental impacts and the need to consider environmental limits. See http://archive.defra.gov.uk/evidence/economics/susdev/documents/esd-review-report.pdf.

Risk and uncertainty

2.22 The Green Book and Impact Assessment guidance asks appraisers to consider the need to adjust appraisals to cater for optimism bias, risks and uncertainties. The impact of risks should be monetised as much as possible, while uncertainties should be taken account of through sensitivity analysis.[15] Such analysis reflects the facts that no forecasts can be perfect, while there is considerable evidence of 'optimism bias' revealed by subsequent evaluations. Risk analysis also forms the basis for risk management: the extent to which risks can be managed is an important consideration when comparing options.

2.23 We found the analysis of risks poor across our sample of appraisals. In five out of eight business cases we found significant risks were not discussed, or risk analysis was not comparable across all options. This picture agrees with that from previous value for money reports. For example, whilst our report on *Providing budget support to developing countries* found that the Department for International Development analysed country's circumstances and systems well when framing its assistance programmes, we recommended that the Department should improve its analysis of the prospect of using budget support by, among others "bringing together the risks and benefits of each option to facilitate comparison".[16]

2.24 While all business cases carried out some sensitivity analysis for the preferred option, we still found weaknesses in four of them; for example, the ranges for the sensitivity analysis were arbitrary, indicating that the sensitivity analysis was seen as little more than a tick-box exercise, or no sensitivity analysis was undertaken for some of the alternative options. The findings from our value for money work further supports our conclusion that the quality of sensitivity analysis in business cases varies within and across departments. We concluded, for example, in our report on the *Financial Management in the Department for Communities and Local Government* that "quality and analysis of financial information presented in support of investment decisions is variable. […] For example, not all business cases contain a sensitivity analysis of the financial data or a compelling body of economic evidence".[17]

2.25 We also found significant gaps in the risk discussion of 33 of 45 Impact Assessment as many Impact Assessments did not contain any discussion of risk, let alone monetised risk values. Similarly, 27 of 45 Impact Assessments did not attempt any sensitivity analysis.

15 *The Green Book,* HM Treasury, 2003, pp. 28-34 and Annex 4; *Impact Assessment Toolkit,* Department for Business, Innovation and Skills, 2010, pp. 61-63.

16 Comptroller and Auditor General, *Providing budget support to developing countries,* HC 6, National Audit Office, February 2008, paragraph 10f.

17 Comptroller and Auditor General, *Financial Management in the Department for Communities and Local Government*, HC 293, National Audit Office, July 2009, paragraph 10.

Part Three

Use of appraisals in the decision-making process

3.1 Good decision-making for government interventions is facilitated by a robust appraisal of the options available. This section presents our findings on the use of both Impact Assessment and business cases when appraising options.

Integration of Impact Assessment with policy development

3.2 For an appraisal process to be influential it has to be completed at a time when it can be acted upon. The Impact Assessment toolkit states that the assessment should be linked to the policy cycle. We found from our interviews with Chief Economists that departments had aligned the policy and Impact Assessment cycle to various degrees. Some departments have explicitly put structures in place so that Impact Assessment is aligned with the development of policy; on the other hand in some departments senior staff thought the formal aspects of Impact Assessment were an 'add-on' to the appraisal process, of little decision-informing value.

3.3 The sentiment of those Chief Economists that considered Impact Assessment templates as an 'add-on' is reflected in the views of staff involved in the process. Our survey results indicate that only 26 per cent see Impact Assessment as pivotal to the decision-making process (see **Figure 10**). This confirmed the result from our Impact Assessment review last year where half of all policy lead staff interviewed reported that they did not find the Impact Assessment useful in developing policy.[18] Several Chief Economists and policy staff noted that in practice the policy process is frequently driven by political judgements or in response to rapidly changing circumstances. In such cases, policies are developed quickly and Impact Assessments are often not finalised until after key policy decisions have been made.

3.4 Our in-depth review of 24 Impact Assessment confirmed these views. We found that those Impact Assessments which we rated as poorer in quality were characterised by the department staff treating them as an add-on.

Figure 10
Survey response to the statement 'Business Cases/Impact Assessments usually play a pivotal role in spending decisions/policy and regulation'

	Impact Assessment		Business Cases	
	Number	Percentage	Number	Percentage
Strongly Agree	2	2	12	24
Agree	22	24	18	36
Disagree	37	40	8	16
Strongly Disagree	15	16	2	4
Neither Agree nor Disagree	16	17	10	20
Total	**92**		**50**	

NOTE
1 Figures do not add up to 100 percent due to rounding.

Source: National Audit Office analysis

18 Comptroller and Auditor General, *Assessing the impact of proposed new policies*, HC 185, National Audit Office, July 2010.

3.5 One of the reasons why Impact Assessment is seen as an add-on is that it is a 'one-size-fits-all' for range of policies and very inflexible. Proposals to regulate come from a variety of sources, such as: manifesto commitments; EU negotiations; unexpected events; court judgements; long-term commitments and requests from stakeholders. In many of these cases the scope for option development and appraisal is limited. The issue of process inflexibility was raised both in this review and in our 2010 review (see **Figure 11** overleaf).

3.6 We found that policy teams/economists adjust to this circumstance and invest less of their analyst resources in those appraisals which they think will make little difference to the decision. We see little added value from the application of the full Impact Assessment process where initial assessment provided a credible basis for assessing impacts as zero or de minimis. A two-level process, where appraisal resources focused on the more material proposals, would gain most value from them, and from associated review expertise. Provided judgements over de minimis status are evidenced, explicit and challengeable, policy objectives for regulation and accountability requirements can still be satisfied.

Knowledge and use of Specific Impact Tests

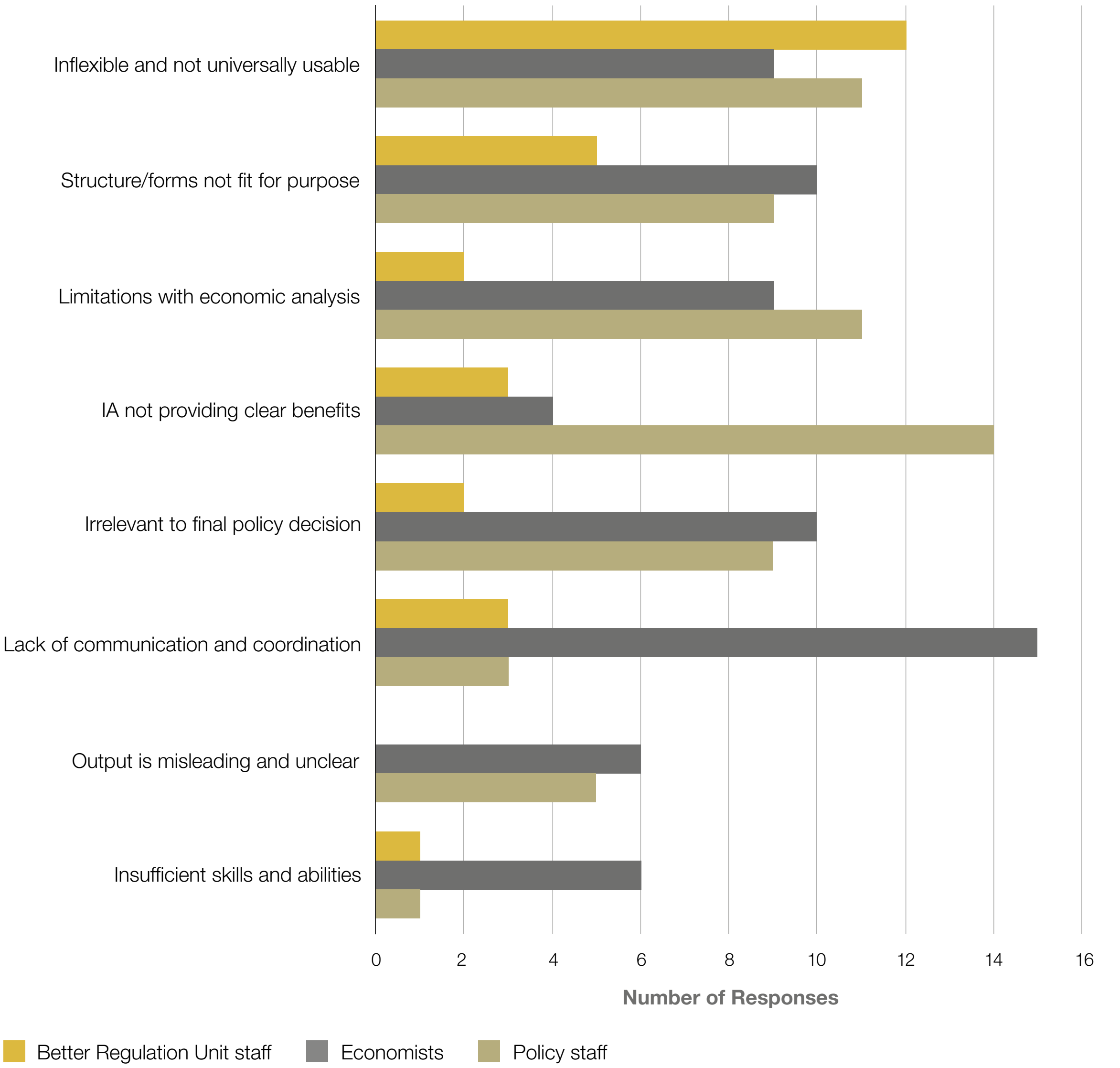
3.7 The Impact Assessment guidance states that for every policy intervention a series of impact tests must be applied to ensure that policy development is joined up and that individual policy proposals take account of the government's broad policy objectives. Some of the tests are designed to help policy makers monetise costs and benefits, whether economic, environmental or social. We have found that the Specific Impact Tests are not comprehensively used and most officials involved in the process misunderstand their use or do not find them useful. When asked in our survey, as many as 48 per cent of respondents involved in writing Impact Assessments were unaware of some tests or did not use them. Our discussions with officials suggested that the specific impact tests were often seen as a 'tick-box exercise'.

3.8 Staff told us that, given a set of impact tests existed, there were pressures for each department to locate their policy interests explicitly in the assessment process by adding extra tests – with risks of increasing the confusion over what is required, and the perception of assessment as a box-ticking exercise. This is one area where the logic of a different approach from business cases or underlying Green Book guidance is unclear. The Green Book states that all the relevant costs and benefits of an intervention should be considered and provides guidance for some non-market impacts, such as environmental impacts. It does not, however, mandate the completion of Specific Impact Tests. If these elements are fundamental to the quality of appraisal they should form part of the Green Book and be reflected in business case structures as well.

Integration of business case process with spending decisions

3.9 In contrast, business cases for spending decisions were seen as central to the decision-making process with 60 per cent of respondents agreeing that they are pivotal to the spending review process. This was supported by our discussion with Financial Directors at four departments. All four of them mentioned that the decisions of investment committees to go ahead with projects and programmes are primarily based on their business cases – although one Financial Director acknowledged that it is not in all cases the investment appraisals alone that influence the preferred option.

Figure 11
Staff views on limitations of Impact Assessments



NOTE

1 Better Regulation Units coordinate within each department the reduction of bureaucracy and regulation resulting from departments' policies.

Source: National Audit Office analysis based on 97 semi-structured interviews (34 economists, 46 policy staff and 17 Better Regulation Unit staff), giving rise to 160 unique comments.

Part Four

Management of the appraisal process

4.1 To understand the variation in quality of option appraisal and its integration we examined the management of the appraisal process. Our work has arrived at a number of key principles that appear to be important in the development of proportionate, high-quality optional appraisal processes.

Departments taking a controlled and consistent approach

4.2 The in-depth review of the appraisal process of 24 final Impact Assessments provided an insight into the factors that appear to be driving the inconsistency in quality of appraisals. During our review we assessed not only the quality of the appraisal achieved throughout policy development but also the approach taken by the department to the development. The highest quality Impact Assessments were produced by those that understood clearly what resources they had and matched them to where they would be most effective. Quality in these cases was not a factor of the size of intervention but the approach and organisation of the staff.

4.3 Departments need to take a planned approach to appraisal development to ensure that staff are involved in the development of the policy throughout the appraisal process. Throughout the process there is a need for the approach to be proportionate to the scale and risk of the policy intervention. We found that departments that produced high quality Impact Assessments structured their approach to option appraisal in the following ways:

- **Planning**: They looked to secure the most value from the processes and sought to work within the given option space to develop options. They built in informal consultation from the early stages of the development and considered how the review of implementations would occur.
- **Resources**: They took a planned approach to the development of the Impact Assessment, including early decisions on the type of staff expertise needed and the timing of their input. They made good use of expertise throughout the process, ensuring consistent challenge and enquiry.
- **Evidence Gathering**: They build on prior interventions and understood the impact those have had. They used central guidance to ensure that all the angles and issues relevant for this Impact Assessment have been covered.
- **Consultation**: They worked with key stakeholders and experts before the formal consultation to establish what facts were known and what options were open to them at that stage. They then used the formal consultation to check for evidence gaps and open the appraisal for wider testing with the prior knowledge that their approach was feasible and achievable.

Matching analytic resources to size of intervention

4.4 In Part Two, we noted that low quality appraisals are often characterised by lack of option development and gaps in the monetisation of impacts. In addition to referring to lack of data and appropriate monetisation models, Chief Economists justified restricted depth of analysis and option development with reference to the principle of 'proportionality' – the need to balance the cost of analysis against the importance and scale of the decision.[19] In their February 2011 report the Regulatory Policy Committee reported that some departments claim the reason for the lack of cost-benefits analysis is that the cost to quantify benefits would be disproportionate.[20] However, we found that departments rarely articulate their definitions of 'proportional'.

19 *The Green Book*, HM Treasury, 2003, p. 19; *Impact Assessment Guidance*, Department for Business, Innovation and Skills, 2010, p. 4.
20 *Challenging Regulation: An independent report on the analysis supporting regulatory proposals September-December 2010*, Regulatory Policy Committee, February 2011.

4.5 Our review suggests that departments often take a pragmatic approach to 'proportionality', which is not based on the professional judgement of the analysts about the evidence needed for the size and importance of the intervention. Decisions on monetisation and option development depend more on the perception of economists that decision-makers face a genuine choice and are open to being provided with a range of options. Our in-depth review of the appraisal process of 24 final Impact Assessments revealed that one of the main factors determining levels of effort put into monetisation was the extent to which the decision on the preferred option was influenced by non-appraisal related factors (e.g. EU directive decisions).

4.6 One way of avoiding pragmatic short-cuts to monetisation and option development is specifying the principles of proportionality more clearly in central guidance. Our work with Chief Economists across government identified the need for a greater central steer on proportionality. Both sets of central guidance, the Green Book and business case guidance, and the Impact Assessment guidance do make references to proportionality but do not provide an analytical framework for making such an assessment.

4.7 Central guidance should set out legitimate determinates of proportionality, such as scope for option development, size of the impacts both by value and sensitivity, availability of reliable evidence resources and the impact of other appraisals being performed. The guidance should also set out a clear requirement for departments to specify their rationale and evidence underpinning proportionality judgements.

Departmental portfolio management

4.8 Our interviews with Chief Economists and Financial Directors revealed that some departments have installed scheduling arrangements for spending decisions, to channel projects systematically through new investment approval governance structures. Such governance arrangements are under increased stress in times of fiscal constraints and at least one department has lowered its internal threshold for submission to internal investment committees. Other departments had less structured arrangements, although officials we interviewed recognised the need to strengthen their systems in this area. For Impact Assessments there is a clearer forward planning programme as the Better Regulation Executive publishes a list of upcoming regulatory actions which includes estimates of the costs and benefits of these measures.

4.9 Such scheduling systems can benefit appraisal quality. Departments which understand what policy and programmes are on the horizon can better plan the most cost-effective deployment of limited analytic resources; and judgements about what constitutes 'proportionate' analysis are better informed. Good forward planning of both regulatory and spending interventions is therefore a key enabler to high quality appraisals.

4.10 Staff also told us of work during the spending review to rank capital programmes and projects according to their benefit:cost ratio. Such work was limited by the availability of cost/benefit information, from plans or from evaluation, and by difficulties in establishing fair comparison. Chief Economists and Finance Directors told us that departments did not generally operate 'portfolio management' arrangements that have been developed in the private sector to help optimise investment plans, by balancing factors such as costs, returns and risks for the portfolio as a whole. We note that a combination of improved levels of monetisation, more structured qualitative analysis and more active scheduling of forward investment, valuable in themselves, could also facilitate broader portfolio management within departments.

Formal departmental quality assurance processes

4.11 Departments are responsible for the quality of their options appraisals and all departments have processes in place to scrutinise quality. There are various ways how quality is assured – for Impact Assessments a major quality assurance mechanism within departments is the Chief Economist sign off. In practice, Chief Economists have a team of economists that quality-assure Impact Assessment before Chief Economist sign-off or they delegate sign-off for minor Impact Assessments.

4.12 There are also detailed processes in place for business cases. Most business cases have to pass through multi-tier investment approval and project assurance processes which also serve as quality assurance systems. In addition, some departments have a dedicated team of Finance specialists or economists that scrutinise business cases before they are submitted to the relevant investment committees and provide additional assurance regarding their quality. As we have shown in previous value for money reports, the close scrutiny of the business case by investment committees is important to ensure, among others, that cost and benefit assumptions are realistic.[21] In addition, the Major Project Authority has now a mandate to provide assurance on large-scale projects, including the quality of the business case. It is within the discretion of the department to invite Gateway review teams for medium- and low-risk projects.

4.13 We have found that each department has different quality assurance processes which operate on a case-by-case basis. Departments rarely have a systematic overview of the quality of appraisals in their department which they can use to target particular problem areas. Chief Economists and Finance Directors identified this as a gap within their appraisal management: we only found evidence in one department where a systematic review of appraisals was undertaken. This review has in fact led to improvements in the quality of appraisals in the long term.

Good practice example

Case study 1: Improving quality of business cases through central challenge by departmental investment committee

In our *Financial Management Report* of the Ministry of Justice we noted that the Ministry has created an Investment Committee to provide a challenge function for investment proposals in excess of £40 million. "The Investment Committee receives business cases in a standard format based on the criteria set out in HM Treasury's Green Book for Appraisal and Evaluation. The Investment Committee is supported by a panel of 'Keyholders', experts in each of the criteria, who undertake an initial detailed scrutiny and challenge of business cases before they are presented to the Committee. There is recognition throughout the Ministry that the Investment Committee challenges business cases robustly and this has led to an improvement in the quality of the submissions it receives. In addition, the Committee has helped to encourage the consistent use of business cases and investment appraisal across the Ministry's Business Groups and arm's length bodies".[1]

Case study 2: Technical Impact Assessment training of staff and peer review challenge system

At one Agency many of the staff throughout the business are being routinely trained in the Impact Assessment process, not just those directly involved in the process. When developing an appraisal the policy lead will set up a group of peers that will be involved throughout the development and appraisal. They will be copied in at all stages, seek each others advice and identify conflicts. Members of the Agency's Board have a clear expectation that the content of the Impact Assessments has been thoroughly challenged.

NOTE

1 Comptroller and Auditor General, *Ministry of Justice Financial Management Report*, HC 187, National Audit Office, July 2010, paragraph 3.32.

21 In the report on *The cancellation of Bicester Accomodation Centre*, the Public Accounts Committee noted, for example, that "in planning this innovative project, the cost benefit analyses were not subjected to close and ongoing scrutiny by the Home Office's Group Investment Board to assess whether the nature and timing of the anticipated benefits were realistic." (Comptroller and Auditor General, *The Cancellation of Bicester Accomodation Centre*, HC 19, November 2007, paragraph 3). However, in our latest *Financial Management* report we have noted marked improvement in the Home Office's governance processes of business case scrutiny and found "that the Group Investment Board and its reviewers […] take an increasingly constructive approach and provide an appropriate level of challenge." (Comptroller and Auditor General, *Financial Management in the Home Office*, HC 299, May 2009, paragraph 3.32).

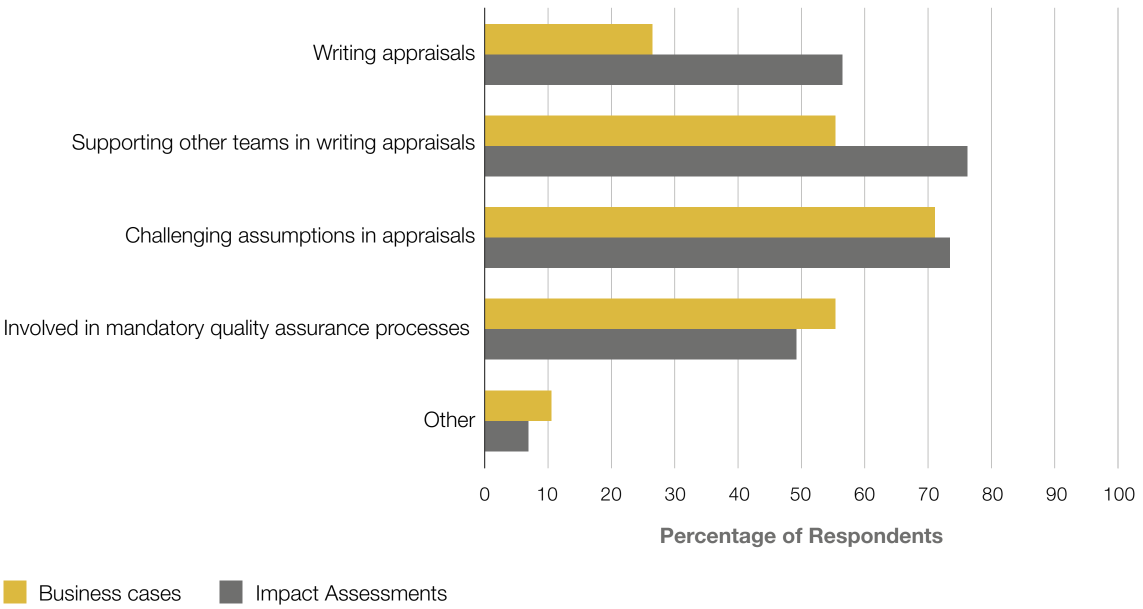
Good practice example
Improving quality of business cases through systemic reviews of appraisals

In one of the departments where we spoke to the Chief Economists, the central economist unit has undertaken a sample review of investment appraisals every six months in the last eight years. This has markedly improved the quality of the investment appraisals: while in 2002-03 about 72 per cent of appraisals were rated as inadequate, in the last year of the review only 24 per cent received that rating.

Processes to promote appraisal quality

4.14 The economists we surveyed play a variety of roles in the appraisal cycle (**Figure 12**). A key quality factor noted by Chief Economists was the early involvement of economists in policy development. This was supported by our in-depth review of the appraisal process of 24 Impact Assessments: quality was high when a variety of staff with different expertise was involved in the appraisal process. The late involvement of economist in the appraisal process, however, had a detrimental impact on the quality of the appraisal. Our survey suggests that economists are still primarily involved towards the end of the appraisal cycle (see **Figure 13**).

Figure 12
Economist involvement in appraisal processes

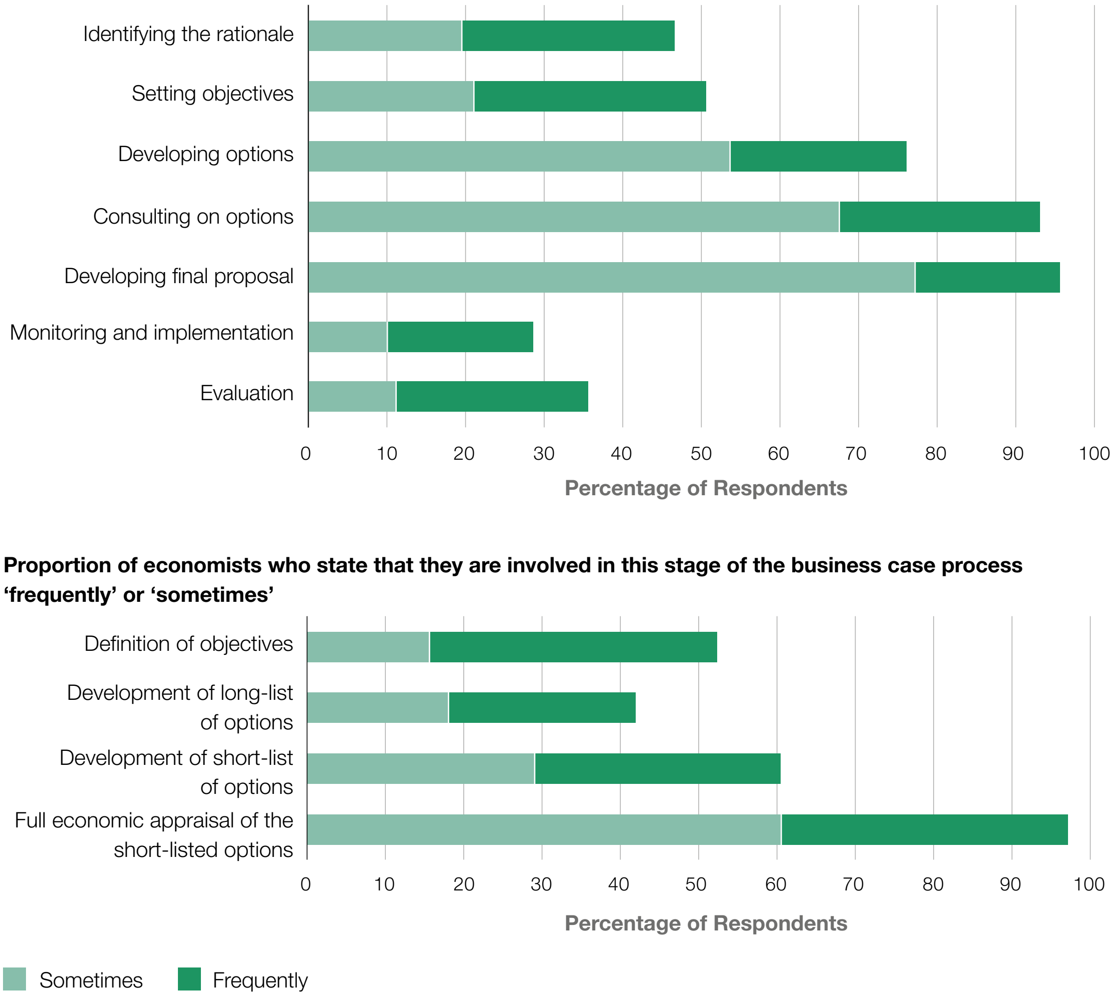


Source: National Audit Office analysis

Figure 13
Economist involvement in appraisal process

Proportion of economists who state that they are involved in this stage of the Impact Assessment process 'frequently' or 'sometimes'

Proportion of economists who state that they are involved in this stage of the business case process 'frequently' or 'sometimes'

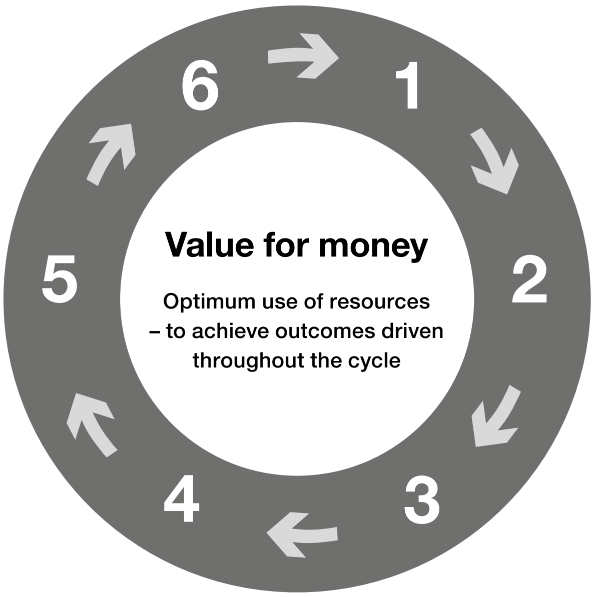


Source: National Audit Office analysis

Making benefit realisation and evaluation part of the wider appraisal cycle

4.15 Option appraisal should not only form the basis for the decision to launch a government intervention but they should be used as 'live' documents throughout the management cycle (see **Figure 14**). They should be integrated as such in the departmental decision-making governance structure, in particular for measuring and monitoring actual benefit realisation against the forecasts benefits in the option appraisal. However, we have found in our value for money reports that departments fail to revisit investment appraisals once the government intervention has been approved to monitor benefit realisation against the forecasts. In our health VFM report on *NHS Pay Modernisation: Agenda for Change*, for example, we noted that in the Department's business case there was a clear expectation that productivity improvements would be delivered but put no mechanisms in place to know whether these had been achieved.[22]

Figure 14
Option appraisal and management cycle



1 Strategy

The department integrates its policy development, impact assessment, and option appraisal processes to enable effective portfolio management and forward planning of government interventions.

2 Planning

The department develops and compares an adequate number of solutions and options for a particular intervention.

The department uses analytic resources for option appraisals proportionate to costs, benefits, and risks identified in the appraisals.

The appraisals monetise the impacts of government intervention sufficiently to allow for meaningful comparisons and priorisation between different government interventions.

3 Implementation

The department has quality assurance processes in place that help produce high-quality appraisals and also allow for a systematic assessment of the department's appraisal capability.

4 Measurement

The department uses option appraisals as 'live' documents during implementation phase to ensure that costs and benefits are within the agreed envelopes.

5 Evaluation

The department schedules formal evaluation when appraising government interventions, appoints responsibilities for the evaluations and compares the outcome of the evaluations against the original options appraisal.

6 Feedback

The department shares lessons learned of completed appraisals and successful monetisation techniques within the department and across government and ensures that this information is used in the new appraisal cycles.

Source: National Audit Office

22 Comptroller and Auditor General, *NHS Pay Modernisation in England: Agenda for Change*, HC 125, January 2009.

4.16 While the measurement and monitoring of benefit realisation should ensure that actual costs and benefits are compared against the benchmarks and targets set out in the option appraisal, evaluations of government intervention are crucial for understanding whether the strategic objectives of the interventions have been achieved.[23] Evaluations also serve as a mechanism for the continuous improvement of appraisals and learning of appraisal staff.

4.17 The Chief Economists we interviewed recognised the importance of evaluations but acknowledged that not enough evaluations are undertaken in their departments and noted that evaluations are not always linked to the appraisal cycle. This concurs with our findings in previous value for money work. In our report on *Regenerating the English Regions* we were, for example, unable to conclude that the Regional Development Agencies' support to physical regeneration projects was value for money due to, amongst other things, weak evaluation. We recommended that the Agencies "use evaluation consistently to provide benchmarks against which to judge the likely benefits of future projects and help guide decision-making about the projects to support".[24]

4.18 In addition, we have also pointed out in some of our reports that the results of routine evaluations are not always fed back to the departmental investment committees. Our *Financial Management Report* on the Foreign and Commonwealth Office showed that while FCO projects undergo a routine evaluation one year after project completion, it was not clear whether this information was shared with the Investment Committee to assess whether projects were realising the expected benefits, and to identify any lessons of broader significance for the Department.[25]

Good practice example
Monitoring the realisation of benefits

Case study 1

In our VFM report on the *BBC's Management of its Digital Media Initiative* we have found that the BBC has made significant improvements in its appraisal process in its benefit realisation management. "Although the original 2008 investment case had categorised and quantified the benefits and given a broad indication of when they would be realised, the benefits had not been assigned to BBC executives responsible for delivering them and it was unclear how the benefits would be measured". However, by June 2010 the BBC had taken, amongst other things, "a systematic approach to revisiting the benefits; and agreeing quantified targets with named benefit owners responsible for delivering the benefits. […] Agreed savings were to be removed from Divisional budgets".[1]

Case study 2

In our *Financial Management Report* of the Ministry of Justice we found that it had introduced a process for monitoring projects that are "classified as 'mission critical' once approval has been given by the Investment Committee, based on an assessment of value and relative risk. Monthly reports for each project are submitted by the project team to the Ministry's Change Division, assessing progress against key milestones and tolerances for five criteria: cost; benefits; people; time; and quality/scope".[2]

NOTES

1 Comptroller and Auditor General, *The BBC's management of its Digital Media Initiative*, National Audit Office, January 2011, para 4.7.

2 Comptroller and Auditor General, *Ministry of Justice Financial Management Report*, HC 187, National Audit Office, July 2010, para 3.32.

23 See *A Short Guide to Structured Cost Reduction*, National Audit Office, 2010, p. 5 'Core Management Cycle'.

24 Comptroller and Auditor General, *Regenerating the English Regions: Regional Development Agencies' support to physical regeneration projects*, HC 214, National Audit Office, March 2010, paragraph 17f.

25 Comptroller and Auditor General, *Financial Management in the Foreign and Commonwealth Office*, HC 289, National Audit Office, June 2009, paragraph 2.45.

4.19 In 2009, at the request of the Lord's Merits of Statutory Instruments Committee, we surveyed departments to establish what post-implementation reviews had been carried out for 2005 Statutory Instruments that had been subject to Impact Assessment. Post-implementation review was not mandatory for the statutory instruments sampled, and our review found that by mid-2009, departments reported that only 29 per cent had been subject to post-implementation review.[26]

4.20 We have only identified one department that had systematically reviewed its evaluation capability, identified gaps, and has started to close these gaps. We suggest that more departments look critically at their evaluation capability and their use of evaluations to inform future appraisals. It is particularly important that evaluations are planned and budgeted within the full appraisal and evaluation cycle of a policy or programme.[27]

Management and administration of process by central government

4.21 This section looks at the management of the current appraisal processes by HM Treasury and the Better Regulation Executive. Improvements in the management of the appraisal process by departments needs to be supported by HM Treasury and the Better Regulation Executive. This would be around the expectations they set, guidance they provide and the coherence of the two processes.

Central government guidance

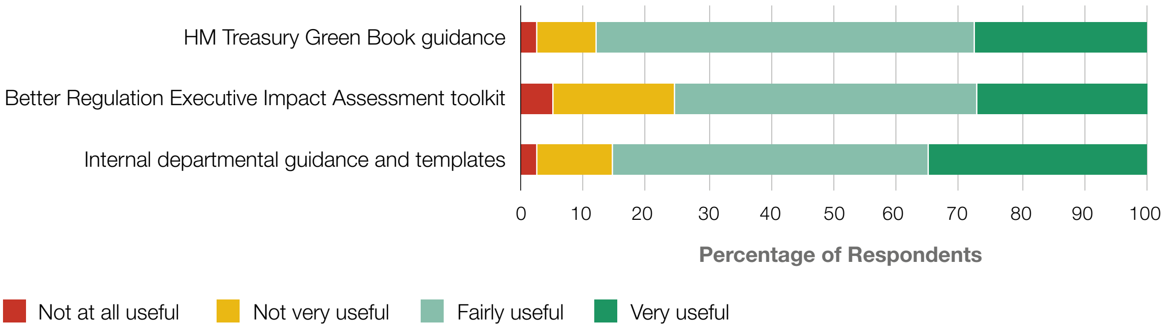
4.22 Generally, staff we interviewed found that the guidance was thorough and thought it to be of good quality. Staff involved in appraisal face a complex array of guidance and possible processes. In writing Impact Assessments, policy leads can refer to the Green Book, Impact Assessment toolkit, business case guidance, internally developed guidance and the guidance relating to the Specific Impact Tests. For business cases HM Treasury publishes guidance and most departments produce internal guidance. The links between the different guidance and the related processes they cover are not always clear to departmental staff, risking duplication and poor compliance.

4.23 The Impact Assessment guidance attempts to deal with the needs of policy officials and economists, but there is evidence that neither group is content. Our 2010 Impact Assessment report showed that a third of policy analysts found the guidance technically complex and that a similar proportion of economists found it had technical gaps and lacked clarity. Our survey showed that departmental staff involved in Impact Assessments found the Green Book more useful than the Impact Assessment toolkit, even though the latter has been specifically designed for the Impact Assessment process (see **Figure 15**).

4.24 As **Figure 16** shows, staff involved in business case processes tend to use the Green Book and internal departmental guidance, rather than the HM Treasury specific business case guidance. The business case guidance is viewed as less useful than the Green Book with 96 per cent of those that use the Green Book finding it very or fairly useful compared to 87 per cent of those that use the business case guidance finding it very or fairly useful.

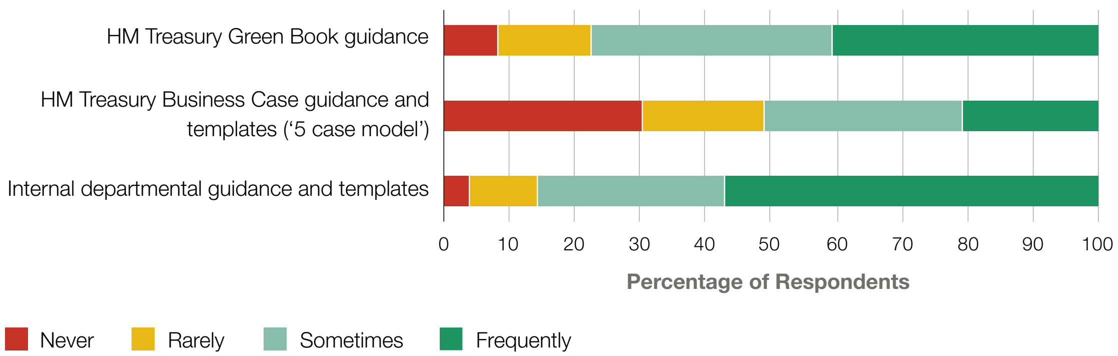
26 HL Merits of Statutory Instruments Committee, *What happened next? A study of Post-Implementation Reviews of secondary legislation*, Eighth Report of Session 2009-10, HL 180, January 2010
27 See here also our report where we identified that currently few high risk projects produced budgeted plans that detailed likely requirements for assurance (*Assurance of High Risk Projects*, National Audit Office, June 2010, p. 20).

Figure 15
Survey responses to 'How useful do you find the following Impact Assessment guidance?'



Source: National Audit Office analysis

Figure 16
Survey responses to 'How often do you use the following business case guidance?'



Source: National Audit Office analysis

External scrutiny and disclosure

4.25 For many years, Impact Assessments have been subject to external scrutiny by an independent body. Since 2010, that has been the Regulatory Policy Committee, which reviews Assessments before they are submitted, together with the relevant piece of regulation, to a parliamentary committee. In addition, Impact Assessments are published at key stages of the Impact Assessment process. Our findings suggest that both these elements improve the quality of the Impact Assessments in the long term. Chief Economists noted that the prospect of strong public challenge to Impact Assessments following their publication was a key factor in incentivising teams to improve assessment quality.

4.26 A similar process of external scrutiny and challenge is missing for business cases. They are reviewed as part of various central government project assurance processes, but not systematically by an external body. Similarly, business cases tend not to be put in the public domain to invite public scrutiny. However, HM Treasury should consider the merits of an external review and the disclosure of business cases to invite more external scrutiny to the business cases (where commercial sensitivities allow). This should lead to a similar long-term improvement in their quality as in the case of Impact Assessments.

Lack of unity between two appraisal processes

4.27 While the Green Book is the intellectual basis for all economic appraisals, distinct processes have developed around business cases, Impact Assessments and for taxation. Such differences risk increasing the overall costs due to the maintenance of separate streams of guidance, and training for affected staff. They can also affect the quality of appraisals if identified impacts are not transferred from one appraisal to the other. We found, for example, one appraisal, where one business case and at least five Impact Assessments were produced. Due to the misalignment of the two processes important wider impacts had only been identified in the Impact Assessment after the decision-making process for the business case had been completed.

4.28 Individual departments coordinate these two processes to different extents and we have come across good practices in some cases. There are links between the processes outlined within the guidance but the variability in coordination shows that these links are unclear. Differences in process add to system cost, however, and are likely to become proportionately more burdensome as resources are constrained. There are likely to be cost reduction and quality benefits from minimising the difference in processes, especially with the likely need to produce appraisals to support the sun-setting of regulations/regulators and demonstrating regulatory outs.

4.29 Closer and clearer links between the business case and Impact Assessment processes will support greater comparability between spending and regulatory decisions. Thus, In the short-term HM Treasury and the Better Regulation Executive should illustrate in the guidance how business cases and Impact Assessments can link together in the life-cycle of an intervention.

4.30 In the long term, there may be an opportunity to join up the two different appraisal regimes, for example, by integrating the oversight and management of the economic element of business cases and Impact Assessments and by developing common forms of analysis and appraisal. For those government interventions that involve both investment and regulation instruments, this would reduce the number of appraisals needed. And for all appraisal work, it should raise the levels of awareness of required practices, and minimise appraisal management, training and review costs.

Appendix One

Methodology

The methods we used to gather evidence	How we used this evidence
1 Analysis of eight business cases in the context of six VFM studies We evaluated the quality of eight business cases and related documents by applying an option appraisal maturity framework that we developed on the basis of the HM Treasury's Green Book and the Better Regulation Executive Impact Assessment guidance.	To analyse: • Overall quality of business cases • Option development • Quality of cost-benefit analysis and levels of monetisations • Level of qualitative assessments of options • Treatment of risks and uncertainty
2 Analysis of 45 Final Impact Assessments We evaluated the quality of 45 Final Impact Assessments by applying our option appraisal maturity framework.	To analyse: • Overall quality of Impact Assessments • Option development • Quality of cost-benefit analysis and levels of monetisation • Level of qualitative assessments of options • Treatment of risks and uncertainty
3 Online survey of economists, policy analysts, statisticians, and other staff involved in option appraisal processes We surveyed 107 officials from 14 government departments and two executive agencies (80 economists, 15 policy analysts/advisers, eight statisticians, four other).	To determine: • Their involvement in at the various stages of the business case and Impact Assessment process • Their views on quality of cost-benefit analysis, levels of monetisation, quality of qualitative assessments, role of appraisal in decision-making process • Their awareness of the Specific Impact Tests • Their views on and use of central government guidance

The methods we used to gather evidence	How we used this evidence
4 Chief Economist and Financial Director interviews	
We interviewed seven Chief Economists and four Financial Directors from eight departments.	To determine their views on: • Option development • Drivers for high quality option appraisals • Difficulties in monetising wider social and economic benefits • Use of portfolio management and scheduling for appraisals • Departmental quality assurance mechanisms • Their involvement in the appraisal process
5 Analysis of the National Audit Office value for money back catalogue	
We searched our back catalogue for conclusions we drew in the last ten years in our value for money work on the quality of option appraisals in departments.	To determine: • National Audit Office's conclusions on the quality of cost-benefit analysis in previous value for money reports

Where to find out more

The National Audit Office website is **www.nao.org.uk**

Twitter: @NAOorguk

If you would like to know more about the NAO's work in this area please contact:
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www.nao.org.uk/performance-measurement

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