

# Assessing business cases for changes to arm's length bodies

## National Audit Office memorandum for the Public Administration Select Committee

This memorandum sets out good practice principles to help in assessing proposed changes to arm's length bodies. The principles are derived in large part from our report on *Reorganising Central Government*,<sup>1</sup> which considered structural changes to government departments and other public sector organisations. While some of the principles outlined here are specifically focused on arm's length bodies, most are general management principles that could be used to assess other types of government reorganisations.

The principles are intended to assist the Public Administration Select Committee with its new role of scrutinising business cases to create new or reorganised bodies. In addition, they have been framed in such a way that they can be used to assess closures of bodies. Departmental select committees may also find the principles helpful in evaluating changes to bodies in their areas.

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<sup>1</sup> National Audit Office, *Reorganising Central Government*, HC 452, Session 2009-10, 18 March 2010, [http://www.nao.org.uk/publications/0910/reorganising\\_government.aspx](http://www.nao.org.uk/publications/0910/reorganising_government.aspx)

## A. Rationale for change

Making changes to any part of government entails costs, both financial costs and disruptions to working arrangements and, potentially, service levels. A convincing case for change therefore needs to set out compelling reasons why change is required and what objectives it is designed to achieve.

A well-founded business case would make clear the logic of the change and, in particular, why existing arrangements are no longer adequate. This requires a reasoned account of why the change is being proposed, with an explanation of the issues motivating the change and how the change will address those issues. In addition, the business case should set out what the change is designed to achieve. Defining the specific objectives of the change in this way provides criteria against which the success of the reorganisation can later be judged.

It is also important that the business case specifies whether relevant parties have been consulted about the change, and how the results of any consultation have fed into the process for deciding and implementing the change.

### *Key good practice principles*

Be clear about why the change is being proposed, and in particular why existing arrangements are not able to deal with the situation.

Be clear about what the change is designed to achieve, and set corresponding objectives which can be tested at a future date.

Consult relevant parties about the change and its objectives, and incorporate consultation feedback in change planning.

## **B. Accountability and public administration impact**

One of the Government's primary justifications for making changes to arm's length bodies is to improve accountability arrangements. Accountability is a complex concept, and it is important that cases for change that rely on accountability improvements consider effects on different forms of accountability: to the relevant department and Ministers, to Parliament, and to the wider public. There may also be impacts on the ability to hold the body to account; for example, if reporting requirements change or if it becomes harder to determine a body's funding and activities.

Accountability arguments need to be weighed against any perceived benefits of making bodies independent from direct ministerial control. For example, the Government has outlined three criteria which it believes justify putting bodies at arm's length from Ministers: where bodies have a precise technical function, where they make politically impartial decisions to distribute taxpayers' money, or where facts need to be transparently determined. All of this means that, where a previously independent body is being brought into a department, the business case needs to identify and answer any concerns about placing it under ministerial control. Equally, for a new body that is being formed from an existing part of a department, any concerns about removing functions from direct ministerial control ought to be highlighted.

There are likely to be wider public administration impacts of the change, such as on the parent department's own administrative and institutional arrangements or on the independence of public appointments associated with the body. Changes to bodies may also mean functions are moved out of the public sector (for example, if privatised or given to a charity), or transferred to or from local government. Where relevant, the business case will need to identify these potential impacts on public administration and address any related concerns.

### *Key good practice principles*

Clarify how the change affects the body's accountability to the relevant department and Ministers, to Parliament, and to the wider public.

Establish whether there are cogent reasons for the body to be independent from direct ministerial control.

Identify any wider public administration impacts, including those on the parent department, other departments and public bodies, and local government.

## C. Options appraisal

A thorough options appraisal is an essential pre-requisite for good decision making on reorganisations. It provides an assurance that the most appropriate institutional form has been chosen – one that best fits the objectives the change is trying to achieve, and which ensures that the change is the most cost-effective one.

The business case needs to demonstrate clear evidence that all feasible options were identified and considered. This should include options that are sometimes overlooked, such as no structural change, but instead making existing arrangements work better; and alternatives to traditional public sector ownership or delivery, such as social enterprises or mutuals. The business case also needs to make clear the basis on which the preferred option was chosen. A robust options appraisal would typically require the selection to be made using appropriate criteria, with trade-offs and compromises among those criteria made explicit, and with assumptions underlying the different options varied and tested.

One important consideration will be whether the preferred option meets the requirements of economy, efficiency and effectiveness. The Government has incorporated these criteria in its *Public Bodies Bill*, and every business case for change will consequently need to address these value for money concerns. In particular, the business case will have to demonstrate that the preferred option is optimal in terms of cost-benefit comparisons (more detail on expected costs and benefits appears in the following sections). We have found this is far from normal practice. In 60 per cent of the changes to arm's length bodies we considered for our *Reorganising Central Government* report, no cost-benefit appraisals of alternative options were conducted before decisions were taken to reorganise.<sup>2</sup>

*Key good practice principles*

Identify all feasible options, including no structural change and alternative delivery models.

Ensure that the option is chosen according to appropriate and well-evidenced criteria, and that key assumptions underlying the different options are tested and varied.

Ensure that the preferred option can be supported on grounds of economy, efficiency and effectiveness, and in particular on comparison of expected costs and benefits.

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<sup>2</sup> *Reorganising Central Government*, para 7

## D. Identifying and managing costs

Effective cost control is integral to planning and implementing successful reorganisations. Government reorganisations are often extremely disruptive and frequently entail higher costs than anticipated. We found that bodies tend to underestimate the overall costs of change for a variety of reasons: because not all sources of costs are identified, because important costs such as loss of expertise and institutional memory are hard to quantify, or because some costs fall on other bodies.<sup>3</sup>

The business case will need to make a comprehensive estimate of the costs of change (see the annex for our typology of expected costs). It is important that as many of the expected costs as possible are identified and expressed in monetary terms, with other non-financial costs specified in measurable terms. Doing so will help ensure bodies have a realistic idea of the resources and funding required to implement the change effectively. It would also help in determining how long it will take for the costs of the change to be recouped.

There will also need to be evidence that sound arrangements in place for managing and controlling costs. The business case should specify how costs are to be recorded, reported and monitored, who is responsible for controlling costs, the main risks to good cost management and how costs will be brought under control if they start to exceed budgeted expectations.

### *Key good practice principles*

Ensure the costs of the change are estimated as accurately and completely as possible.

Express costs in monetary terms as far as possible, and specify other non-monetary costs in measurable terms.

Specify how long it is expected to take for costs to be recouped.

Put in place sound arrangements for recording and monitoring costs, and for bringing costs back on track if they start to exceed those budgeted.

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<sup>3</sup> *Reorganising Central Government*, para 2.7

## E. Identifying and realising benefits

In order to achieve value for money from reorganisations, benefits need to be greater than under the previous arrangements and with a value that exceeds associated costs. It is therefore important that anticipated benefits are outlined clearly and comprehensively. However, we have found that central government bodies are weak at identifying and systematically securing the benefits they hope to gain from reorganisation.<sup>4</sup>

The business case should identify and explain the expected benefits of the change and, as far as possible, put them in specific, measurable and monetary terms (see the annex for commonly claimed benefits we have identified). The requirement to be precise about expected benefits will help in assessing whether they are plausible, and later in tracking whether they have been realised. Another key consideration that needs to be covered in the business case is how bodies will know whether benefits have been achieved and whether this is within the time expected. As with cost control, there will need to be appropriate arrangements to monitor benefits and to identify and manage key risks that would prevent them from being realised.

### *Key good practice principles*

Ensure the expected benefits of the change are fully identified, and as far as possible expressed in measurable and monetary terms.

Define the timeframe for realising benefits, and the evidence needed to show that benefits have materialised.

Put in place appropriate arrangements to monitor benefits, and to manage risks that threaten those benefits being realised.

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<sup>4</sup> *Reorganising Central Government*, para 6

## F. Managing the change

Good project management and strong leadership are crucial to ensuring that change is implemented successfully. It is important that responsibilities for leading and implementing the change are well defined, in order to provide clarity about how the reorganisation will take place. We found, however, that only a quarter of arm's length bodies had project plans in place before announcing reorganisations, and only a third of bodies assessed risks in advance.<sup>5</sup>

The business case needs to provide assurance that there is effective senior leadership support for the change implementation process, and that a dedicated staff team with the necessary skills will be appointed to manage the transition. In addition, implementation needs to be informed by an understanding of how staff members will be affected by the change; this will involve identifying anticipated staff impacts, such as on motivation and morale. Alongside this, details of the change process will need to be clearly communicated to staff members.

An essential requirement is a detailed implementation delivery plan, to ensure key deadlines and the resources needed to implement the change are clearly defined. It should be clear from the business case how risks to implementation will be identified and minimised; in particular, how implementation will be brought back on track if it starts to slip or go over budget. One frequently encountered risk involves situations where two or more bodies are being brought together: the business case will need to explain how old 'silos' will be broken down and different organisational cultures integrated.

### *Key good practice principles*

Ensure board-level support and clear leadership for change.

Ensure there are clear responsibilities for delivering the change, and that staff with appropriate skills are appointed to the implementation team.

Ensure there is a detailed implementation plan covering risks, deadlines, budget and impact on service levels.

Specify anticipated staff impacts and ensure changes are clearly communicated to staff.

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<sup>5</sup> *Reorganising Central Government*, para 8

## G. Evaluation and review

Wider lessons can be learned from individual changes to arm's length bodies, since reorganisations often involve similar processes and challenges. Our *Reorganising Central Government* report concluded that while central government bodies commonly try to learn lessons from reorganisations, they do not share this learning widely.<sup>6</sup> Provision for thorough evaluation and review should be made at the outset to ensure that lessons can be captured, shared and applied in order to prevent common mistakes or problems recurring.

The business case should explain the review arrangements put in place to assess how well the change was managed and whether it has achieved its objectives. An initial review would ideally take place reasonably soon after the change has been implemented, so that the lessons of the change can be identified, reported and applied to other relevant areas. Each body should also consider whether it needs to conduct ongoing evaluation to assess whether the long-term objectives of the change, such as improving accountability, are being met. This would be a separate exercise from the Government's planned periodic reviews of all arm's length bodies, which will be conducted every three years to determine whether bodies should continue to exist.

### *Key good practice principles*

Ensure effective review arrangements are in place to evaluate the change shortly after implementation, in order to identify and apply wider lessons.

If appropriate, define ongoing review arrangements to track whether the long-term objectives of the change, such as improved accountability, are being achieved.

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<sup>6</sup> *Reorganising Central Government*, para 3.12



## Annex: Types of expected costs and benefits from reorganisations

The following types of expected costs and benefits arising from government reorganisations are drawn from the NAO's reports on *Reorganising Central Government* and *The Creation of Ofcom: Wider Lessons for Public Sector Mergers of Regulatory Agencies*.<sup>7</sup>

### Types of expected costs

#### *Staff costs*

- Staff project costs
- Recruitment costs
- Temporary staff costs
- Redundancy costs
- Relocation costs
- Salary uplifts where bodies with different pay scales merge
- Training costs
- Consultation process with staff
- Indirect staff costs, for example, senior staff planning time, non-project staff time

#### *Property/accommodation costs*

- Capital acquisitions/refurbishments
- Removal costs
- Lease exit payments/restoration costs
- Service contracts – new/exits

#### *Information technology costs*

- Capital IT additions
- IT consultancy costs
- Service contracts – new/exits/transition costs

#### *Communication and branding costs*

- Signage and other branding
- Website development
- Stakeholder communication
- Public awareness/advertising

#### *Corporate costs*

- Corporate services, such as human resources and finance support
- Professional fees
- Other consultancy costs

#### *Other indirect costs*

- Productivity losses where change is disruptive or staff morale falls
- Losses of expertise and institutional memory
- Adverse effects on third parties, such as reduced customer or stakeholder satisfaction, decreased responsiveness to customers, or increased burdens on businesses and other organisations

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<sup>7</sup> National Audit Office, *The Creation of Ofcom: Wider Lessons for Public Sector Mergers of Regulatory Agencies*, HC 1175, Session 2005-06, 5 July 2006, [http://www.nao.org.uk/publications/0506/the\\_creation\\_of\\_ofcom\\_wider\\_1.aspx](http://www.nao.org.uk/publications/0506/the_creation_of_ofcom_wider_1.aspx)

## **Types of commonly claimed benefits**

### *Financial savings*

- Improved operational efficiency
- Ability to cease lower priority functions or activities
- Economies in back office functions (for example, through shared services)
- Estate and other asset rationalisation

### *Improved policy focus and delivery*

- Greater clarity about core priorities and organisational targets
- Improved capacity to meet policy objectives
- Increased effectiveness of policy or service delivery
- A more coordinated/'joined-up' policy approach
- For regulatory bodies, improved regulatory outcomes (for example, clarity and certainty of regulatory approach)

### *Better management and governance*

- Clearer governance and management structures
- Improved financial management
- Improved accountability
- Ability to devolve functions to most appropriate level
- Higher staff welfare and satisfaction
- Greater transparency about organisational functions and activities

### *Beneficial third party effects*

- Increased responsiveness to customers/service users or external parties
- Higher customer/service user satisfaction
- Reduced burdens on business, other organisations or individuals