Division of Local Government
Department of Premier and Cabinet

Capital Expenditure Guidelines

December 2010

These are Director General’s Guidelines issued pursuant to section 23A of the Local Government Act 1993.
ACCESS TO SERVICES
The Department of Premier and Cabinet, Division of Local Government is located at:

Levels 1 and 2
5 O’Keefe Avenue                Locked Bag 3015
NOWRA NSW 2541                  NOWRA NSW 2541
Phone 02 4428 4100
Fax 02 4428 4199
TTY 02 4428 4209

Level 9, 323 Castlereagh Street
SYDNEY NSW 2000                  Locked Bag A5045
SYDNEY SOUTH NSW 1235
Phone 02 9289 4000
Fax 02 9289 4099

Email dlg@dlg.nsw.gov.au
Website www.dlg.nsw.gov.au

OFFICE HOURS
Monday to Friday
8.30am to 5.00pm
(Special arrangements may be made if these hours are unsuitable)
All offices are wheelchair accessible.

ALTERNATIVE MEDIA PUBLICATIONS
Special arrangements can be made for our publications to be provided in large print
or an alternative media format. If you need this service, please contact our Executive
Branch on 02 9289 4000.

DISCLAIMER
While every effort has been made to ensure the accuracy of the information in this
publication, the Division of Local Government expressly disclaims any liability to any
person in respect of anything done or not done as a result of the contents of the
publication or the data provided.

© NSW Department of Premier and Cabinet, Division of Local Government
ISBN 1 920766 81 2

Produced by the Division of Local Government
# TABLE OF CONTENTS

1 Purpose and Scope of Guidelines ................................................................. 4
2 Overview ........................................................................................................ 4
3 What projects do the guidelines apply to? ................................................. 5
4 What projects are exempt from the guidelines? .......................................... 5
5 Unplanned asset replacement arising from premature failure ................. 6
6 s23A Guidelines ........................................................................................... 6
7 When do councils need to notify the Division and notification requirements ......................................................................................... 6
8 Council Responsibilities ................................................................................ 7
9 Preliminary Business Case ............................................................................ 8
10 Capital Expenditure Review Minimum Requirements ............................. 9
   10.1 Outline proposed Project ...................................................................... 9
   10.2 Justify the Need .................................................................................. 9
   10.3 Assess the Capacity of Council ............................................................. 10
   10.4 Priorities ............................................................................................. 11
   10.5 Alternatives ......................................................................................... 11
   10.6 Financial Implications ........................................................................ 12
   10.7 Public Consultation Process ................................................................. 13
11 Capital Expenditure Review Additional Requirements – project costs in excess of $10M (ex GST) .............................................................. 14
   11.1 Business/Management Project Plan ...................................................... 15
   11.2 Risk Management Plan ....................................................................... 17
   11.3 Probity Plan ......................................................................................... 19
   11.4 Tender Evaluation ............................................................................... 19
12 Reporting ...................................................................................................... 20
13 Summary Flow Chart .................................................................................. 21

1 Purpose and Scope of Guidelines

These Guidelines have been developed to assist NSW councils prepare Capital Expenditure Reviews. Capital expenditure is incurred when a council spends money to buy, construct, renovate or acquire an asset.

The Guidelines have been designed to:

- encourage councils to evaluate major capital expenditure by means of a consistent methodology
- improve the quality of council's analysis performed in supporting all forms of project funding and capital expenditure
- enable the financial impact of projects on a council to be quantified, identified and controlled.

The Guidelines aim to ensure that a council’s evaluation of the proposed capital expenditure is consistent and rigorous, the merits of projects can be compared and resource allocation can be made on an informed basis. It is important that the evaluation of the project is carried out in a clear, transparent and systematic way. The process of evaluation and reporting methods outlined in these Guidelines will enhance the transparency and rigour of capital expenditure project evaluation.

Capital Expenditure Review is a necessary part of a council’s capital budgeting process and as such should be undertaken as part of the Integrated Planning and Reporting requirements in the preparation of the Community Strategic Plan and Resourcing Strategy.

2 Overview

As councils are responsible for the prudent management of community resources, it is important that as part of council’s normal planning process, councils undertake a Capital Expenditure Review before committing to any major capital project.
3 What projects do the guidelines apply to?

These guidelines apply to capital projects for infrastructure facilities, including renovations and extensions that are expected to cost in excess of 10% of council’s annual ordinary rate revenue or $1 million, whichever is the greater (GST exclusive).

In addition to the minimum requirements for a Capital Expenditure Review, a council is also required to complete additional requirements in cases where a project’s cost is forecast to exceed $10 million (GST exclusive).

Councils may consider it prudent to undertake Capital Expenditure Reviews for projects under the threshold, but this will be at a council’s discretion.

4 What projects are exempt from the guidelines?

The guidelines do not apply to:

- capital expenditure on land purchases, land remediation, water supply networks, sewerage networks, stormwater drainage, domestic waste management facilities, roads, footpaths, bridges;
- projects where funding has been approved under the Public Reserves Management Fund Act 1987;
- projects that are classified as Public-Private Partnerships;
- project designs and feasibility studies that do not commit council to the project (the cost of such studies are to be included if council subsequently proceeds with the project).

While the guidelines do not apply to the projects described above, capital expenditure on such things as land purchase for an applicable project should be included as part of the capital expenditure review of that project.

Although a project may be exempt from the submission of a capital expenditure review to the Division, it is expected, that in accordance with best practice, councils should apply the principles of these guidelines to all capital projects.
5 **Unplanned asset replacement arising from premature failure**

From time to time, councils may be required to undertake emergency work to replace assets due to premature failure, fire, flood or accidental damage.

In these circumstances, council should take the opportunity to review and assess the assets. In undertaking this assessment, council should consider these guidelines in conjunction with council’s asset management plans, the asset’s prior serviceability and community requirements prior to replacement.

6 **s23A Guidelines**

These guidelines have been issued by the Chief Executive of the Department of Premier & Cabinet, Division of Local Government (under delegated authority) in accordance with section 23A of the *Local Government Act 1993* (the Act). As such councils are required to take them into consideration before exercising any of their functions.

7 **When do councils need to notify the Division and notification requirements**

Councils are required to notify the Division of all capital expenditure projects to which these Guidelines apply, prior to the commencement of the project.

Notification to the Division will include:

- A brief description of the project
- The estimated cost of the project and proposed funding sources
- Anticipated start and completion dates
- A brief commentary on how the council has fulfilled each of the Capital Expenditure Review requirements relevant to the project based on cost.
Council may be requested to provide additional information to the Division in some instances. The Division reserves the right to assess the process undertaken by the council for the capital expenditure project, but it will not approve or endorse the project itself.

If a council is requiring special variation funding for the capital expenditure, council must complete the capital expenditure review and submit this to the Division prior to submission of the special variation application.

If project costs increase by 10% of the initial costs at any time, council must notify the Division of the revised project cost and give a brief explanation as to the reasons for the increase and the council’s process and plans to meet these increases. Council should also keep the community informed of cost increases and associated reasons.

8 Council Responsibilities

Councils have a responsibility to their community for the prudent management of community assets and finances.

To establish the project costs, all elements of the project must be taken into account. This includes feasibility studies, project design and scoping costs, the provision of non-monetary goods and/or services and any costs associated with the development application and its conditions.

Where a project is conducted in stages, it is to be considered as one project. Councils are not to break a project up into smaller parts in order to avoid the threshold requirements contained in these Guidelines.

9 Preliminary Business Case

Before a council undertakes a capital expenditure project a preliminary business case must be prepared to determine whether the proposal is necessary, consistent with council’s community strategic plan, delivery program and operational plans,
offers value for money and that the council has the capacity to deliver and maintain their current and future community services in the long term. The council must demonstrate that its decision to carry out the capital expenditure is based on sound strategic and financial planning, supported by valid data and research; and that it reflects the views, priorities and objectives of the broader community.

Councils are required to prepare a preliminary business case for each council project to which these Guidelines apply. It is also appropriate to prepare a preliminary business case for any project assessed or considered as high risk.

The preliminary business case describes the high level objectives for the project and identifies possible alternative proposals. It should outline the risks, sustainability issues, costs and benefits relevant to these alternatives, as well as identify any assumptions on which the proposal(s) are based.

Cost estimates should be reasonably reliable but not to the level of accuracy as required in the capital expenditure review. The more accurate the costing is, the more useful it will be for the decision making process.

It is expected that the cost estimate in the preliminary business case be within 15% of the project’s final cost.

The ongoing costs relating to the capital works project (i.e., lifecycle costs), should also be identified.

The amount of detail in the preliminary business case should reflect the proposed project’s scale, cost and risk.

The governance model and internal controls, which will be utilised to manage project risks and assist the successful completion of the project, should also be identified. For example, preliminary business cases should include information relating to the project’s Steering Committee, Project Team, monitoring and review systems and if necessary, Probity Advisor and internal audit program.
The preliminary business case should be supported by evidence and evaluate the service needs, options and implementation of the proposal. The evidence must be based on quantitative and qualitative data, use established methodologies that assess costs and benefits and link resources to services and results via evidence-based results logic. It is important that any assumptions on which supporting data is based are clearly identified.

Once a council is satisfied that sufficient information and evidence has been provided in the preliminary business case and has resolved to continue with the project, a Capital Expenditure Review should be prepared.

10 Capital Expenditure Review Minimum Requirements

The following are the minimum requirements for a Capital Expenditure Review. It is recommended that councils undertake this review as part of their internal control processes for all material or high risk capital expenditure projects, irrespective of the funding source.

It is also considered best practice for councils to complete a capital expenditure review for projects exempt from these guidelines.

10.1 Outline proposed Project

- Council should give a brief outline of the project.

10.2 Justify the Need

Justify the need for the proposal based on firm estimates of future needs, including:

- demonstration of a clear relationship between the proposal and council’s community strategic plan, delivery program and operational plan
- completion of a business case / feasibility study
- analysis of community needs and expectations based on community consultation, which should identify how the project will address specific community needs and any issues of public access and equity
• an outline of the projected costs in council’s long term financial plan and asset management plans.

10.3 Assess the Capacity of Council

Assess the capacity of council to manage the project to completion and into the future by:

• determining the capacity of council’s management and skill base to undertake the project

• identifying the responsibilities of council to the project on a year-by-year basis throughout the project’s lifetime. These responsibilities must be itemised and costed (see 10.6 Financial Implications)

• undertaking a risk assessment of the project including:
  
  o assessment of the governance and management structures in place to effectively minimise project risks. The appropriate structure will depend on the type and complexity of the project and the stakeholders involved. It would be expected that council has an internal audit function as part of its governance structure.
  
  o assessment of compliance requirements including but not limited to the Local Government Act 1993, Environmental Planning and Assessment Act 1979, Heritage Act 1977 and any other legislation considered appropriate for the project

• considering the appointment of a Steering Committee

• designating a project manager. Councils should ensure that candidates for this position have the appropriate skills, expertise and experience to manage the project. A rigorous and open recruitment process should be undertaken by council to ensure that an appropriate candidate is found. Once a project manager has been designated, council should ensure that sufficient delegations are granted to allow the manager to undertake the work.
10.4 Priorities

Determine the priority of the project in relation to existing capital commitments and future works by:

- assessing the impact of the project’s funding on existing and future capital works and services in accordance with council’s long term financial plan
- reviewing the community strategic plan, delivery program and operational plan to ensure the proposal is aligned to council’s objectives, and
- reviewing the asset management plan/s to ensure that other assets do not require the funding as a higher priority

In accordance with the Integrated Planning and Reporting framework, councils will also have developed and put in place, current asset management plans that give consideration to future infrastructure needs. Proposed capital expenditure for infrastructure must be included in these plans, including appropriate linkages to council’s delivery program and operational plan.

10.5 Alternatives

Consider the full range of project alternatives, including:

- the preparation of a project plan with appropriate economic appraisals of council’s preferred and alternative options
- an assessment of alternative service delivery methods
- an assessment of alternative methods of acquisition. Possible alternatives to consider include renting, renovating, constructing, or acquiring an existing building
- the consequences of not proceeding with the proposal.
10.6 Financial Implications

Project costs should be considered from a ‘whole of life’ perspective. They should also be included in a council’s long term financial plan as part of council’s Integrated Planning and Reporting framework. These costs should include, but not be limited to:

(i) design costs
(ii) the costs of land acquisitions
(iii) the costs of land disposals
(iv) land and property development costs
(v) raw materials costs
(vi) maintenance and other ongoing operational costs
(vii) depreciation and/or provisions for replacement costs
(viii) labour costs
(ix) opportunity costs
(x) overhead costs, such as project management
(xi) payments and fees, including expenses and allowances, to external providers and council’s consultants and advisers
(xii) loan and/or other financing establishment costs
(xiii) plant and equipment costs

- sourcing of funds:
  (i) where funds are to be borrowed council must comply with Part 12, Chapter 15 of the Act and with the Ministerial Borrowing Order, which can be located in the Code of Accounting Practice and Financial Reporting on the Division’s website at www.dlg.nsw.gov.au
  (ii) where funds are to be sourced by way of internal loans council must obtain Ministerial approval and comply with s410(3) and s410(4) of the Act
  (iii) where funds are to be sourced by way of a special variation, approval must be sought under Part 2, Chapter 15 of the Act

- identification of any potential increase in council’s actual or prospective expenditures, whether in terms of one-off capital amounts or recurrent expenditures. This includes consequential recurrent costs such as maintenance, debt servicing, staffing, etc
• identification of systems in place to monitor and control increases in project costs

• identification of any potential loss in the value of council’s assets or a potential loss in actual or prospective revenue

• consideration of the possible inability of council to discharge its Charter obligations to provide adequate, equitable and appropriate services and facilities for the community

• cash flow analysis. This should detail council’s ability to repay any loans required for the project. The cost of funds and the effect of debt servicing, including internal reserves, should also be considered

• Net Present Value calculations – cost/benefit. Break even analysis for best, worst and likely scenarios.

It is expected that in the capital expenditure review there will be a higher level of accuracy in relation to estimated costs than the preliminary business case. It is expected that the cost estimate in the capital expenditure review will be within 5% of the final cost.

When calculating future costs it is appropriate that project costs are indexed based on prudent and reasonable assumptions. These assumptions should be documented and able to be provided on request or provided as part of the project’s capital expenditure review.

10.7 Public Consultation Process

Councils must undertake public consultation and engagement processes prior to making any commitment to the project. Like other aspects of council business, councils are strongly encouraged to involve the community in decision making around capital projects. It is a requirement under these guidelines, that councils prepare a report on the public consultation process undertaken to bring the project to the review state as well as providing details on the process, for ongoing reporting on the project to the council and the community. The report should include:
how council conveyed the social, economic, employment, financial and environmental impacts of the project to the community

confirmation that the project is included in the council’s community strategic plan, delivery program and operational plan

details of the consultation processes council has in place to allow participation by affected groups and consideration of their views

a public interest evaluation showing a positive outcome for the broader community, which includes but is not limited to; effectiveness, accountability and transparency, equity, public access, consumer rights, security and privacy.

details of the methods used by council to inform the broader community of the proposed project, its key elements and decisions made in relation to the project. This may include community newsletters, community surveys, newspaper or radio advertisements, etc.

council’s planning process to enable the community be provided with sufficient information to be adequately informed. To be considered sufficient the delivery program and operational plan should include:

• purpose of project and benefits to the community
• costs and funding sources, and
• construction time frames

details of the public reaction to the proposal including any statistics on the outcome of surveys, any correspondence received from the community, etc

details on any public meetings held in regard to the proposal

11 Capital Expenditure Review Additional Requirements – project costs in excess of $10M (ex GST)

In addition to the minimum requirements set out above, a council is also required to complete the following additional requirements in cases where a project’s cost is forecast to exceed $10 million (GST exclusive). For projects below the $10 million threshold, the additional requirements are optional. They are considered best
practice and councils are encouraged to complete them for all projects which are considered high risk or of material costs.

Where the project costs fall into the above category, councils are also required to carry out a more intensive community consultation process. This may include additional consultation with specific groups and/or the community in relation to the detailed components of the project. It could involve community meetings, surveys and information sessions.

11.1 Business/Management Project Plan

Councillors must complete a comprehensive business/management project plan. The plan should contain the key elements and deliverables of the project and outline the costs and revenues associated with them. Details should include, but not be limited to:

- the business structure, if appropriate
- key personnel and their relevant experience
- description of the proposal and its product/service
- current market position and the potential for growth
- the business objectives both in the short and long term
- the reason the proposal will be successful
- financial projections.

The financial projections should include:

- both direct and indirect costs, separately identified
- both capital costs and ongoing recurrent costs, as well as any other expenses that are expected to occur once the project has been delivered and is operational
- inclusion of these projections in council’s long term financial plan and asset management plan.
A report on all financial implications is to be prepared, including:

- an economic/market appraisal which includes:
  
  (i) a cost/benefit analysis test (where major benefits can be quantified)

  The analysis needs to be conducted with objectivity and balance. The cost benefit analysis has to account for benefits to the public as a whole. It is important that the views and assumptions used in the analysis are thoroughly tested for validity and reasonableness. In particular, it should be ensured that views of the wider community are considered.

  The analysis of the benefits and costs needs to be unbiased and the conclusion transparent. This helps ensure that the conclusion has not been predetermined. The analysis must be rigorous, where conclusions follow logically from the analysis and the evidence considered.

  The economic/market appraisal should show a positive result in terms of monetary or community benefit. In the case of business undertakings, full competitive neutrality pricing requirements should be applied and all ongoing expenses taken into account.

  (ii) an analysis of cost effectiveness (where outputs are not readily measured in monetary terms)

  The analysis should consider but not be limited to issues such as:
  
  - Environment – effects on land, flora, fauna, air and water
  - Heritage – impacts that effect the existence or integrity of an historical site
  - Quality of Life – impacts that alter the population’s enjoyment of life
  - Health & Safety – that the community is not exposed to unnecessary health or safety risks
• Law & Order – change in the maintenance of law and order in the community

11.2 Risk Management Plan

Council must develop and put into operation an appropriate risk management plan for the project. The plan should be reviewed, updated and amended as and when required during the development of the project. All potential risks must be identified and addressed. Risks may not only be measured in monetary or financial terms. Possible risks may include:

Investment/Planning Risk
• Investment/planning risk relates to the quality of the planning that has contributed to the investment proposal. It can help to identify critical issues that may not have been considered as part of the planning process or potential costs and benefits that have been incorrectly estimated. There is also the risk that community needs have been misunderstood or that the services to be delivered by the project will not meet needs or expectations.

Design Risk
• Design risk relates to the level of complexity of the project, the extent to which proven technology will be used to achieve the projects aims and the realism associated with the time period estimated for completion
• External approvals risk relates to issues associated with obtaining approval for the proposal to proceed including public consultation, planning approval, environmental approvals, heritage approvals, etc.

Demand/Market Risk
• The demand or market risk relates to whether there is sufficient demand for the proposed project in order for it to succeed or that the proposed fees and charges will adversely affect demand.
Management/Operations Risk
- Management risk relates to the role management plays in ensuring that the investment delivers the expected outcomes. Where the management team named in the proposal has no experience in dealing with similar projects, this increases the risk and lessens the likelihood of success. Operations risk relates to the operational problems that may occur if the project is not planned and managed correctly.
- As part of the assessment of operations risk, council should also consider whether it has adequate insurance coverage for the project and whether or not it has obtained adequate legal advice, if necessary for the project to be delivered.

Reputation Risk
- Reputation risk looks at issues relating to council’s reputation being effected if the project is not completed or does not meet its targets or the expectation of the community. Other issues to be considered as part of this analysis could include such things as cost overrun, time overrun, impractical designs and looking closely at council’s community consultation to ensure the project is supported by the community and wider public.

Compliance Risk
- Compliance risk relates to the risk that the project fails to comply with any relevant regulations, legislation or polices, eg planning, heritage or environmental.

Completion/Construction Risk
- The completion/construction risk relates to the risk that the proposed project will not be completed in accordance with the specifications and within the stipulated timeframe and/or budget. In assessing such a risk, consideration will need to be given to the potential external and financial impacts of such outcomes.
Environmental Risk

- Environmental risk refers to the impact of the proposal on the environment and will encompass the criteria previously considered.

Occupational Health and Safety Risk

- All occupation health and safety issues need to be considered such as construction material, noise and site safety.

Other Risks

- Any other proposal implementation risk not identified under the above headings should be documented and assessed
- Councils should also consider what actions will be undertaken if the project is not meeting and or achieving milestones or costs, eg cost blowouts, builder insolvency, unexpected economical situations, unexpected excavation costs

11.3 Probity Plan

Councils must develop a probity plan for the project. A probity plan is needed to ensure:

- that the project process is transparent, that conflict of interests are avoided, pecuniary interests declared and that the project complies with competition laws and principles
- if land is to be rezoned, that the development application process is outlined with particular attention paid to the separation of council’s roles as landowner and consent authority
- the plan may need to include documentation of the relationship between the parties involved in the project, eg, the independence of parties from the project, council or prospective private sector bidders for the project.

11.4 Tender Evaluation

The tendering process should be in accordance with the Division’s Tendering Guidelines. The Local Government (General) Regulation 2005 and the Local Government Act 1993. Councils should detail how the tendering/contracting process
will be conducted, ie, tender stages, details of assessment panels, assessment process (including proposed evaluation criteria) and short listing.

12 Reporting

Councils must put mechanisms in place to report on all aspects of the project. Minimum reporting requirements for all capital expenditure projects include:

- quarterly reporting to the council on the progress of the project
- quarterly reporting to the council on the costs and budget variances regarding the project. Where costs and budget variances are reported by line item, the report should also include the impact on the total project
- any issue that may have an adverse impact on the project (this may include monetary and non-monetary inputs and outcomes). The risk management plan may be relevant in this regard
- reporting capital works projects in council’s annual report, which is considered to be best practice.
Project Identified in Community Strategic Plan, and Delivery Program

Preliminary Business Case Completed

Council assesses project viability

No

Yes

Project costs >$1 million or 10% of annual ordinary rate revenue (which ever is the greater) (GST exclusive)

No

Yes

Capital Expenditure Review required:
- Project Outline
- Justify the need
- Assess council capacity
- Consider priorities
- Consider alternatives
- Assess financial implications
- Public consultation

Additional requirements:
- Business / Management Project Plan
- Risk Management Plan
- Probity Plan
- Tender Evaluation

Notify DLG of project

Report quarterly to council on progress until completion

Notify DLG of any project cost increases >10% of initial costs

Is the project exempt from the Guidelines

Yes

No

Council to reconsider project

Council discretion to undertake review, but recommended

Project Costs > $10 million (GST exclusive)

Yes

No

Council to reconsider project

Report projects in Council's Annual Report

Preliminary Business Case Completed