The Treasury

Budget 2015 Information Release

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[14] Not in scope

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In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

INTERNAL AFFAIRS
Te Tari Taiwhenua

THE TREASURY
Kaitohutohu Kaupapa Rawa

Joint Report: ICT Common Capabilities programme – proposed deficit write-off in Budget 15

Date:	3 March 2015	**Report No:**	T2015/379
		File Number:	ST-4-7-4-1

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	**Agree** the level of deficit write-off to be considered in budget 15	6 March 2015
Associate Minister of Finance (Hon Steven Joyce)	**Agree** the level of deficit write-off to be considered in budget 15	6 March 2015
Minister of Internal Affairs (Hon Peter Dunne)	**Agree** the level of deficit write-off to be considered in budget 15	6 March 2015

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
Gerald Minnee	Manager, Budget & Public Services, Treasury	04 917 6152 (wk)	021 057 8087 (mob)	✓
Duncan Reed	General Manager, System Transformation, DIA	04 495 7202 (wk)	021 270 4691 (mob)	✓

Actions for the Minister's Office Staff (if required)

Return the signed report to Treasury.

Enclosure: No

Joint Report: ICT Common Capabilities programme – proposed deficit write-off in Budget 15

Executive Summary

This report provides information on options for Budget 2015 for writing-off debt incurred by DIA in developing the Common Capabilities programme for the system[1]. It recommends a $7 million capital injection, which would allow the GCIO to reach break-even in five years, and opex of $0.560 million per annum to fund the resulting capital charge.

Recommended Action

We recommend that you:

1. **note** that **Option B** ($7 million deficit write-off and $0.560 million opex per annum to fund the resulting capital charge) is recommended as it aligns with the typical IT lifecycle and incentivises the GCIO to exceed uptake targets;

2. **note** that under **Option B** the deficit will be paid off in FY20, although the level of debt is likely to go up and down in that time;

3. **agree Option B** as the preferred option to be considered in Budget 15;

Agree/disagree	*Agree/disagree*	*Agree/disagree*
Minister of Finance	Associate Minister of Finance	Minister of Internal Affairs

4. **agree** to a deficit cap of $5.0 million against which the GCIO will report to Ministers;

Agree/disagree	*Agree/disagree*	*Agree/disagree*
Minister of Finance	Associate Minister of Finance	Minister of Internal Affairs

5. OR if you disagree with **Option B**, **indicate** either **Option A** ($5 million), or **Option C** ($10 million write-off) as your preferred option to be considered in Budget 15.

Agree/disagree	*Agree/disagree*	*Agree/disagree*
Minister of Finance	Associate Minister of Finance	Minister of Internal Affairs

[1] While this report refers to the accumulated memorandum account 'debt', from the Crown's point of view these deficits are not debt in the technical sense as the Crown cannot owe money to itself. The term is used in the non-technical sense to illustrate the concept of paying back accrued deficits.

Gerald Minnee
Manager, Treasury

Duncan Reed
Manager, System Transformation
Department of Internal Affairs

Hon Bill English
Minister of Finance

Hon Peter Dunne
Minister of Internal Affairs

Hon Stephen Joyce
Associate Minister of Finance

Joint Report: ICT Common Capabilities programme – proposed deficit write-off in Budget 15

Purpose of Report

1. At your meeting on 10 February 2015 about funding options for the GCIO's ICT Common Capabilities programme, you indicated your preference for a funding model based on service fees charged to agencies as they use each Common Capability product (similar to the MBIE procurement model). You directed officials to develop options for Budget 15 for writing-off debt (a capital injection) incurred by DIA in developing Common Capabilities for the system, to make the procurement approach viable. This note outlines the options and gives you the opportunity to shape the resulting budget bid.

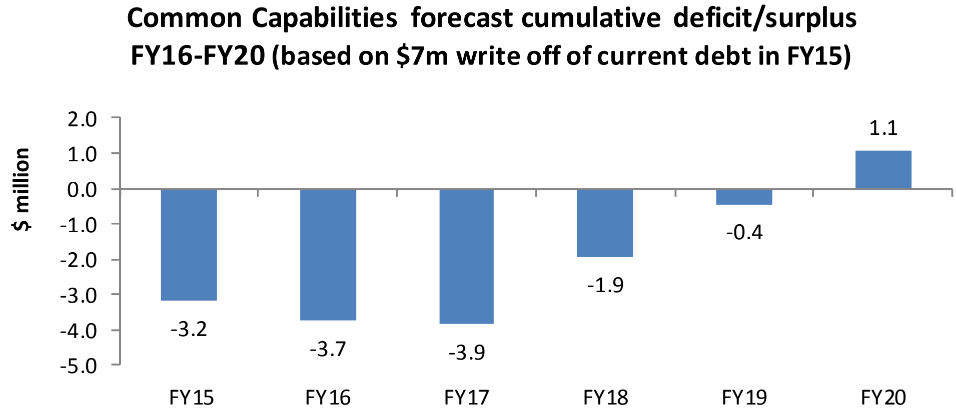
Analysis

2. In developing the current suite of ICT Common Capabilities, DIA has accumulated memorandum account deficits of $10.187 million.

Options for writing off the debt

3. The GCIO, in consultation with Treasury, has developed options for the appropriate level of deficit write-off – these include writing off the full amount, $7 million, and $5 million. These options offer Ministers the opportunity to 'set the dial' appropriately to ensure there is a balance of stretching incentives on the GCIO to drive uptake, at the same time allowing enough scope for the GCIO to have a sustainable and achievable funding model going forward. See Annex 1 for more detail about the options and their pros and cons.

4. The preferred option is **Option B** ($7 million write-off) which would allow the GCIO to reach break-even in year 5 (FY20 as shown in the chart below). This aligns with a typical IT lifecycle of 5 years when refresh/enhancement of services would be expected. It also offers downwards pressure on the GCIO to realise current uptake forecasts, with regular six monthly progress reporting back to Ministers. **Option B** also allows enough time for agencies to absorb the current set of common capabilities.



5. We also propose that the annual capital charge of $560,000 associated with the $7 million capital injection is funded centrally. This is because the level of deficit write-off proposed in this paper has been set at the point at which DIA will be able to generate enough revenue to covers costs within five years. This recognises that DIA will still benefit from strong signals from the users of the common capability products, but will also be able to reach a position whereby they are covering their costs in a reasonable timeframe. If DIA has to recover the capital charge through fees charged to agencies, the timeframe for reaching a full cost recovery position will be extended beyond five years.

Deficit management and reporting

6. Under **Option B**, current forecasts show that the cumulative deficit would reach around $4 million in FY17. However, the deficit would be paid off in FY20. To ensure that debt is managed appropriately, we recommend a debt cap of $5.0 million against which the GCIO will report to Ministers.

7. Partial write-off of the $10.187 million will also include reorganising the GCIOs existing three memorandum accounts into one account to follow the approach MBIE uses to manage its procurement function. The GCIO will report back to Ministers every six months on progress against the current agency uptake forecast and the current and future forecast position of the single common capabilities memorandum account.

Risks

8. As outlined, with a $7 million capital injection, the deficit in the memorandum account will still increase, peaking at FY17, and then start to steadily decrease. The revenue forecasts in this report are based on stated commitments made by agencies about when they will migrate to using each common capability product. It is likely the forecasts will change as agencies mature in their use of the common capabilities approach. If this happens, it will more likely be stronger uptake than predicted rather than weaker. If uptake is less than predicted, Ministers will have early warning in the proposed 6 monthly reporting.

Next Steps

9. The ICT Common Capabilities budget bid will be changed to reflect Ministers' preferred option.

10. DIA will report to Ministers every 6 months on agency uptake of common capabilities and annually on the level of debt in the memorandum account.

Annex 1: The options for writing off the ICT Common Capabilities memorandum account debt

Debt write-off options (as a capital injection)	Amount left to be paid for through fees	Years to reach break-even point	Pros	Cons
Option A $5 million + associated capital charge	$5.187 million	2021/22 (7 years)	Incentive for the GCIO to stretch beyond forecast uptake	A typical lifecycle of IT products and services is approximately 5 years. Having no capital available to fund pipeline development for 7 years puts at risk the ability of the government to take advantage of cost savings offered by new common capability solutions.
Option B $7 million + associated capital charge (preferred option)	$3.187 million	2019/20 (5 years)	Incentive for the GCIO to stretch beyond forecast uptake Good fit with a typical 5 year IT products and services lifecycle Allows agencies time to absorb current common capabilities	There is a risk that it will constrain the GCIO from offering new common capabilities that become available in the 5 year time period
Option C $10 million + associated capital charge	$0.187 million	2017/18 (2 years)	Allows GCIO to begin to develop new common capability solutions sooner May mean that more cost effective common capabilities are available earlier to agencies	Reduces incentives for the GCIO to stretch beyond forecast uptake.