

Understanding the costs: incorporating financial analysis into policy advice papers

Financial analysis has always been an important part of policy advice

While there isn't an explicit heading about financial analysis in the Policy Quality Framework (PQF), the need for assessment of costs, costs of different options, risks associated with those costs, and benefits are woven throughout the standards.

Financial analysis skills don't get much of an outing in the Policy Skills Framework either.

However, Cabinet papers have very specific requirements for defining the financial implications of proposals.¹

Given the fiscal conditions, this sort of information and analysis is always important for decision-makers, but arguably, proposals will get even more scrutiny now.

We see some great examples of robust financial analysis in papers, but we also see plenty of examples where the presentation of the analysis is not up to scratch. It could, therefore, leave decision-makers with questions and uncertainties.

We've certainly seen several high-profile examples where problems with financial analysis have stymied major projects, e.g. ferry replacements or Dunedin Hospital.

This masterclass focuses on what a Minister/s will want to know about the financial implications of a proposal when making a decision. There are some key questions to be answered when making financial recommendations.

We've developed a short checklist – based on our experience and the available guidance – see Table 1 in the Appendix.

Financial analysis needs to be tailored to the issue

The extent of the financial analysis required depends on the scale of the issue and the level of risk involved. So, we'd expect a more in-depth analysis to be undertaken and presented in the paper for more significant issues.

Do the analysis, then present the results in the paper

Financial analysis should be done like other key elements of the policy development process, e.g. risk assessment, stakeholder engagement, or collecting the evidence together. The analysis needs to be done, and the results presented in the paper to your Minister/Cabinet. The advice paper doesn't need all the details (if needed, this can be in a separate document). However, the paper needs to give assurance to Ministers about the robustness of the analysis.

Start early and include financial analysis in your planning

The extent of the financial analysis required needs to be thought about at the commissioning stage of the project. This way it can be incorporated into the work plan.

It may well need some specialist skills and input from outside of the policy team.

¹ <https://www.dPMC.govt.nz/publications/cabinet-policy-paper-template>

There might also be a need for a specialised QA of the analysis. In many cases, it will be important to involve the Treasury, too.

It takes time – don't leave it until the last minute.

The financial analysis may need to be refined as the policy work evolves

Of course, the development of the financial analysis will be iterative. As options are developed (and further refined), a financial analysis will be required. Cost may be a key criterion² for assessing options – indeed, financial analysis could rule some options out altogether.

It can be technical; get help

There will be people in your policy team experienced in this sort of analysis. These are often the people that lead on the Budget work each year. But there will be experts on your financial teams as well.

There may be some specialised requirements

For some matters, there are specialised requirements. For example:

- Approval of formal Business Cases for capital/operating expenditure³ – the Better Business Case methodology includes specific requirements set out in detail in the guidance and templates.
- Budget process – each year, the Treasury provides templates for Budget bids which have specific requirements in relation to financial analysis.
- Regulatory Impact Assessment⁴ – there are requirements for assessing the costs and benefits of proposals. No doubt there will be more in this area as the new Ministry for Regulation steps up its work.

- The Treasury also has technical guidance on writing formal financial recommendations in papers to Cabinet or joint Ministers.⁵
- Actuarial/Social investment considerations – some financial analysis will benefit from an actuarial analysis, so the life-time costs and benefits of a proposal can be considered. We hope that the new Social Investment Agency will develop some more guidance in this area over time.

In conclusion

Financial analysis is always important but even more critical at times of fiscal constraint. You need to show that any expenditure is effective and focused. Robust financial analysis, clearly presented, is critical.

It may be an area where agencies need to build skills and capabilities.

² Masterclass no. 27 Options analysis
https://www.nzier.org.nz/hubfs/Masterclasses/Central%20Government/brief_27_options_analysis.pdf

³ <https://www.treasury.govt.nz/information-and-services/state-sector-leadership/investment-management/better-business-cases>

⁴ <https://www.regulation.govt.nz/>

⁵ <https://www.treasury.govt.nz/publications/guide/writing-financial-recommendations-cabinet-joint-minister-papers>

Appendix A Checklist

Table 1 Financial analysis – things to consider

Questions	Other Considerations
How much?	
What are the costs for the government?	<ul style="list-style-type: none"> Are there costs that will fall on different parties? E.g. local government, firms, individuals, etc. We'll cover cost-benefit analysis in another masterclass.
What are the costs over time?	<ul style="list-style-type: none"> Remember to factor in future costs over the life of the programme/initiative and how these might change.
What are the key factors underpinning the costings?	<ul style="list-style-type: none"> What assumptions have you made? What are these based on? For more in-depth analysis – how will costs change if assumptions change?
Is there any precedent for what you are recommending?	<ul style="list-style-type: none"> What's been done in similar situations or previous years? Why is it different?
How reliable are your costings?	<ul style="list-style-type: none"> What are the risks and uncertainties associated with them? For more complex and more significant proposals, a range of scenarios could be modelled, with different risks factored in. Who has been involved in developing them? What expertise do they have? Have they been subject to QA? Have other related agencies been involved? Has the Treasury been involved, and what do they think?
How does it fit with existing budget allocations?	
Where is the funding coming from?	<ul style="list-style-type: none"> I.e. where in the agency's budget is it going to be taken from? Which type of appropriation or funding pool? Are there any rules associated with that funding that need to be considered and built into the policy design?
Is it within budget? Do you have sufficient funding for this purpose?	<ul style="list-style-type: none"> Will this expenditure impact the availability of funding for other situations? Or do you need to reallocate from another pool? And if so, what are the consequences of doing that? Will it impact other expenditure decisions? Do you need formal financial recommendations to accompany the proposal? Who can sign these off? (your Minister, joint with the Minister of Finance, or Cabinet?).
If new funding is required, are there any off-setting savings?	<ul style="list-style-type: none"> How does the proposal fit within the standard Budget cycle?
Are there costing options?	
Ideally, all options should be costed. But the key question to answer is: What would you achieve with slightly more funding than you recommend or slightly less funding?	<ul style="list-style-type: none"> Give some scaled funding options (this is standard practice in Budget bids). This helps to show what you are recommending is optimal.
How is expenditure going to be monitored?	
How is expenditure going to be monitored and reviewed?	<ul style="list-style-type: none"> This needs consideration to make sure it is appropriately spent and accounted for.

This paper was written by NZIER in February 2025. For further information, please contact anyone from our policy advice team:

Cathy Scott at cathy.scott@nzier.org.nz

Todd Krieble at todd.krieble@nzier.org.nz

John Yeabsley at john.yeabsley@nzier.org.nz

NZIER | (04) 472 1880 | econ@nzier.org.nz

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