Cross-Agency Funding Framework

Guidance for funding cross-agency initiatives

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THE TREASURY
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Overview

Purpose of the framework

The purpose of the cross-agency funding framework (the framework) is to make cross-agency funding easier and reduce the transaction costs of working across agencies. Cabinet agreed to adopt the framework in December 2014.The framework clarifies the range of funding models available and resets expectations about when to pursue particular funding arrangements.

The framework has three broad types of funding model: cost-recovery charges, pooled funding and centrally determined funding. The framework includes funding principles, decision tools and key questions to guide agencies through the process of identifying the most appropriate funding model(s) for cross-agency initiatives.

Scope of the framework

The framework is intended to apply to cross-agency work involving departments and other entities (eg, Crown entities, non-government organisations, businesses etc). The framework is principles-based and operates within current legislative settings and requirements (eg, requirements in relation the independence of Crown entities). Its applicability in particular circumstances should be assessed on a case by case basis. Where existing funding arrangements are working well, no change is required. In other situations, the framework provides a basis for thinking about and making changes to funding arrangements.

How to apply the framework

The framework does not impose ‘hard rules’ or provide for ‘tick-box’ decisions. The nature of the benefits, stage of development and the number of agencies involved are key considerations in choosing an appropriate model. Contextual factors (eg, materiality, practicality and Government objectives) should also inform judgements in specific cases and decisions may diverge from the framework.

Agencies should seek chief executive, board and/or Ministerial approval to establish specific arrangements as required, using regular decision making processes (eg, the Budget).

Types of funding models

Cross-agency funding models can be grouped into three broad types.

1 Cost recovery charges

These are bilateral arrangements, where an agency buys a service from another agency and the provider recovers costs through a service fee. The provider may have a specialist skill / role in the public sector.

2 Pooled funding

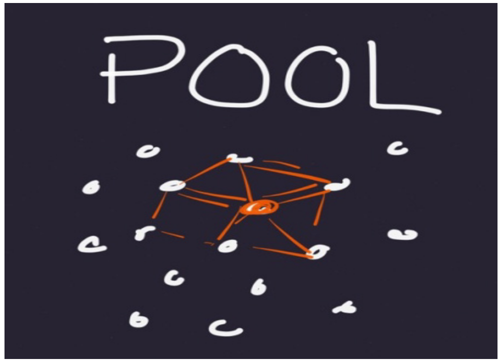
These are joint arrangements where a small group of agencies pool funds to share the cost of an initiative to achieve a common goal. Often used for time-limited activity (eg, a pilot).

3 Centrally determined funding

These are situations where Ministers allocate funding to perform a cross-agency activity, including activities performed on behalf of the public sector. Suitable for system-wide initiatives where the benefits to agencies are not commensurate with the costs incurred, or where many agencies are involved. In these situations, voluntary cost-recovery or pooled funding models cannot be easily established and sustained.

Centrally determined funding requires Ministers, supported by central agencies, to determine that an activity is to be performed and funded on a cross-agency basis. Centrally determined funding does not imply new Crown funding. Ministers decide how much of the required funding is to be sourced from mandatory baseline contributions and/or new Crown funding. Some baseline contribution from agencies involved is likely to be appropriate where an initiative involves doing an existing activity in a new way, results in efficiency gains or cost avoidance, or if agencies can absorb costs.

Figure 1: Models for funding cross-agency initiatives



COST RECOVERY CHARGES

- An agency provides a good or service to another entity and charges a fee to recover costs
- Agencies have a 'customer-provider' relationship and the provider may have relationships with several customer agencies (or third parties)
- The provider may have a specialist skill or role
- Source of funding: agency or third-party charges

Examples: Crown Law, Audit NZ, Procurement Levy (some mandatory elements), PIF Reviews

POOLED FUNDING

- A small group of agencies pool funds and work together to achieve a common goal
- Often supported by:
  - cross-agency governance to facilitate joint decision-making
  - in-kind contributions from agencies (eg, staff, resources, assets)
- Agencies have a 'partnership' relationship
- Source of funding: agency baselines

Examples: Justice Sector Fund, Central Agency Shared Services, PIF Programme (hybrid)

CENTRALLY DETERMINED

- Funding allocated to agency baselines to perform a cross-agency activity, often on behalf of the State sector
- Suitable for system-wide initiatives where the benefits to agencies are not commensurate with the costs incurred, or where many agencies are involved
- Ministers, supported by central agencies, decide that the initiative is to be performed and funded on a cross-agency basis
- Sources of funding: mandatory contributions from agency baselines and/or new Crown funding

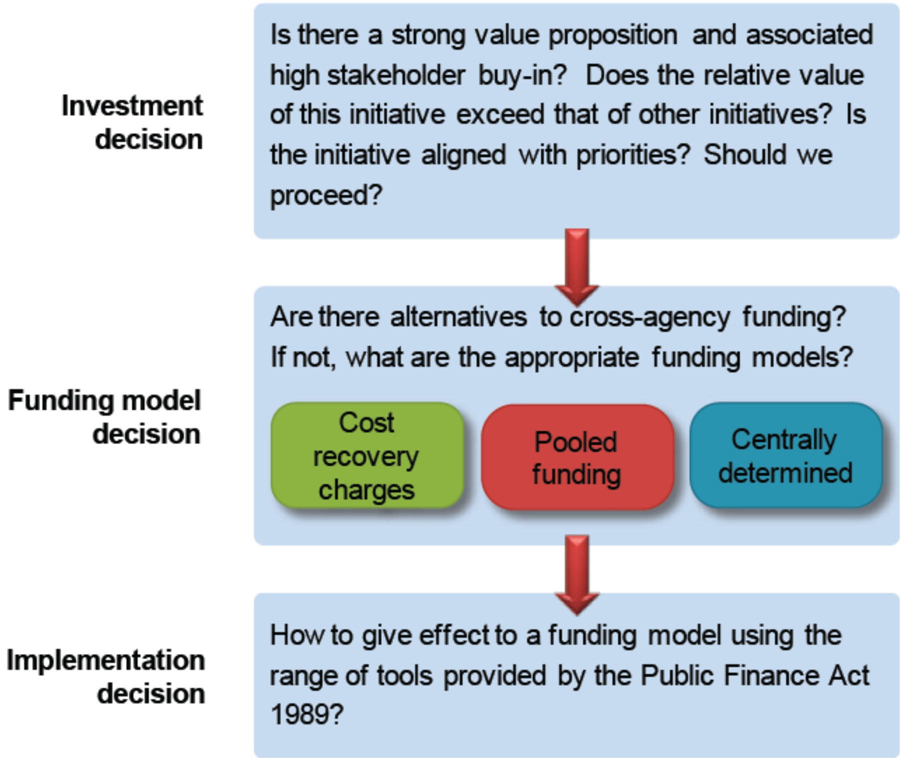
Examples: BPS Seed Fund, Analytics & Insights

Stronger	***Benefit/cost alignment***	Weaker
Weaker	***Weight on collective interest***	Stronger
Voluntary	***Participation***	Mandatory

Steps in funding a cross-agency initiative

The choice of funding model should be distinguished from decisions about whether to proceed with an initiative (the investment decision) and how to give effect to the chosen model under the Public Finance Act 1989 (the implementation decision).

Figure 2: Steps in funding a cross-agency initiative



The key considerations in each of these stages are outlined below.

The investment decision

Proposals for new cross-agency initiatives should have a strong value proposition and be robustly weighed against alternative options. Proposals should be supported by robust analysis of the magnitude and distribution of costs and benefits, evidence of genuine stakeholder support and where appropriate, a sound business case. This information will inform not only whether the initiative proceeds, but also the design of specific funding arrangements and the extent of any baseline contributions.

The funding model decision

The following section of this document is designed to assist agencies to identify suitable funding model(s). However, before going down this path, agencies should consider whether the initiative can be implemented without the need for complex funding arrangements. For ease and simplicity, lead agencies may choose to simply resource an initiative from within baselines without requiring financial contributions from other agencies. Where one agency has a specialist skill or capability that another agency requires, an in-kind contribution of staff or assets may be sufficient. For initiatives that provide direct benefits to third parties (eg, private sector, customers) third-party funding such as user charges may be appropriate.

The implementation decision

Amendments made to the Public Finance Act in 2013 provide new tools to support cross-agency initiatives. These include multi-category appropriations, and administration and use provisions. Cabinet Office circulars provide Joint Ministers with significant flexibility to make changes to baselines and balance sheets.

Cabinet decisions are likely to be required where the policy issue is significant, new funding from the Budget allowances and/or complex changes to appropriations are required (eg, simultaneous movements across multiple appropriations and fiscal years - even when no new funding is required).

The Treasury can support agencies to work through how practically to give effect to chosen funding model(s). All of the funding models outlined in this document can be implemented using the range of tools currently available under the Public Finance Act 1989. Typically, in the ways outlined below:

Cost recovery charges	Pooled funding	Centrally determined funding
• Typically the provider agency would have multiple service agreements and/or 'memorandums of understanding' with customer agencies. • Relevant appropriations administered by customer agencies would continue to be funded from their usual revenue sources. • The relevant appropriations administered by the provider agency would be funded, at least in part, from customer agencies, by revenue department or revenue other (probably with a memorandum account to manage across years).	• Typically the participating agencies will have joint decision–making processes eg, with terms of reference and/or a 'memorandum of understanding' setting out agency roles, responsibilities and decision rights. • The agencies would consolidate funding, which can be given effect in a number of ways, including: fiscally neutral adjustments to an appropriation administered by one of the agencies, or using the provisions of the Public Finance Act that allow one agency to use an appropriation for departmental expenses or a multi-category appropriation administered by another department.	• Ministers, supported by central agencies, decide the relative value, strategic alignment and priority of initiatives within the broader State sector reform and fiscal context. Agency participation/contribution can be mandated. • Ministers determine funding models for initiatives and have options about the funding sources (baseline contributions and/or new Crown funding). • Ministers can implement arrangements with current tools (eg, multi-category appropriations, administration and use provisions, fiscally neutral adjustments). There is also significant flexibility delegated to Joint Ministers to make changes to baselines. • Cabinet decisions are likely to be required where the policy issue is significant, or where new funding from the Budget allowances and/or complex changes to appropriations are required.

Choosing a funding model

The following principles, key questions and decision matrix are designed to assist agencies to work through their particular circumstances to identify suitable funding model(s).

In some instances, choosing a hybrid model, or diverging from the funding model otherwise implied by this framework may be appropriate. A summary of the key choices involved in choosing a funding model is provided on page 8.

Cross-agency funding principles

The following principles generally apply when choosing a cross-agency funding model:

1 There are no 'hard rules' or 'tick-box' decisions. The nature of the benefits, stage of development and the number of agencies involved are key considerations in choosing an appropriate model. Contextual factors (eg, materiality, practicality and Government objectives) should also inform judgments in specific cases.

2 Cost recovery charges are suitable for customer-provider transactions between agencies (or third-parties) that involve direct benefits to the purchaser.

3 Pooled funding is suitable for activities involving a small number of committed agencies with a common goal and where the associated transaction costs are low.

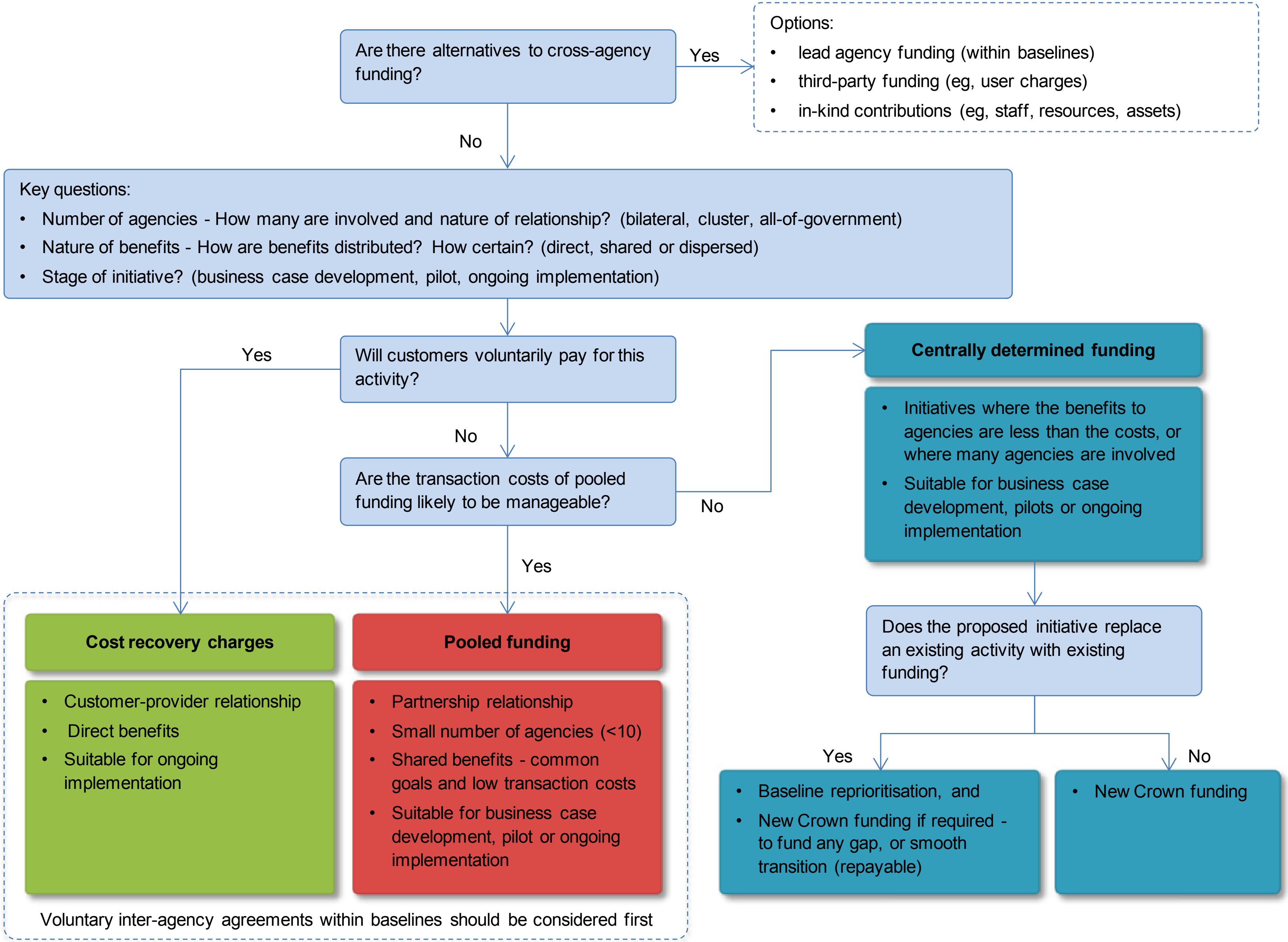
4 Transaction costs tend to increase when many agencies are involved ie, cross-agency engagement, negotiation and decision making becomes increasingly difficult. Agencies may be reluctant to participate in cross-agency initiatives when the benefits to themselves are not commensurate with the costs incurred. Uncertainty over agency participation makes it hard to develop and implement cross-agency initiatives (eg, due to free-riding and opt-outs).

5 Centrally determined funding – is suitable for system-wide initiatives where the benefits to agencies are not commensurate with the costs incurred, or where many agencies are involved. In these circumstances, it can be difficult to establish and sustain voluntary cost-recovery or pooled funding models. Options include:

   a) Replacement of existing activity – many initiatives involve doing an existing activity in a new way. A baseline contribution from agencies is appropriate if freed-up funds can be used for the replacement activity. New Crown funding may be appropriate if existing funding is insufficient, or if 'smoothing' across years is required (generally repayable)

   b) New activity – a baseline contribution from agencies is appropriate if the activity results in efficiency gains for agencies or cost avoidance, or if agencies can absorb costs. New Crown funding may be suitable for initiatives where there are likely to be high transaction costs or if agencies are unable to absorb costs.

Key questions for choosing a funding model



Key questions to inform funding model selection

The questions below should be considered alongside the following decision matrix to determine the appropriate funding model(s) for a particular cross-agency initiative.

Key questions	Likely responses / considerations
1 What type is the cross-agency initiative?	*Business case, pilot, replacement of an existing activity or a new activity*
2 How many agencies are involved?	*Bilateral (ie, two agencies), cluster of agencies, all-of-government*
3 What are the direct costs and benefits of the specific initiative?	*Increased efficiency, effectiveness, cost savings, cost avoidance, reduced duplication, better coordination etc*
4 Who receives most of the benefits of the initiative? Who incurs the costs?	*Agencies involved in the initiative, the wider public sector, third parties or the public*
5 How certain are the benefits?	*Certain, uncertain or unclear*
6 Does the proposed initiative replace an existing activity for which there is existing funding?	*If the proposed initiative replaces an existing activity funded through baselines, it may be appropriate to reallocate existing funding. Other centrally determined funding may be considered where this existing funding is insufficient, or 'smoothing' across years is required.*
7 Given the answers above, which funding model(s) may be appropriate?	*Cost recovery, pooled funding, centrally determined or a combination of models (hybrid)*
8 Where pooled funding seems appropriate – will high transaction costs make this model unsuitable?	*Pooled funding works best where agencies receive direct benefits from participation, the distribution of costs and benefits are aligned and effective cross-agency governance and decision making can be established. This can become difficult as the number of agencies involved increases.*

Decision matrix

= Possible = Unlikely

Number of agencies involved

Stage of initiative

<table>
<tr><th></th><th>‘Bilateral’
Two agencies involved</th><th>‘Cluster’
A group of agencies involved</th><th>‘All-of-Government’
Most / all of State sector involved</th></tr>
<tr><td rowspan="3">Developing a business case / Piloting an initiative</td><td>Cost recovery – unlikely, as the benefits will be uncertain and, if they accrue, will be shared by the agencies</td><td>Cost recovery – unlikely unless one agency leads on behalf of agencies that directly benefit and are willing to pay</td><td>Cost recovery – unlikely unless one agency leads and all agencies benefit, to the extent they are willing to pay</td></tr>
<tr><td>Pooled funding – suitable if the benefits accrue directly to the two agencies</td><td>Pooled funding – suitable if agencies are likely to benefit, but not if transaction costs are high</td><td>Pooled funding – unsuited as a large number of agencies implies high transaction costs</td></tr>
<tr><td>Centrally determined – suitable if the benefits are uncertain or likely to be widely dispersed</td><td>Centrally determined – suitable if the benefits are uncertain or dispersed or if transaction costs are high</td><td>Centrally determined – suitable if the benefits are uncertain or dispersed or if transaction costs are high</td></tr>
<tr><td rowspan="3">Implementation / delivery
Replacement of an existing activity or a new activity</td><td>Cost recovery – suitable if there is a skilled provider agency and if the purchaser receives a direct benefit</td><td>Cost recovery – suitable if there is a skilled provider agency and if agencies that directly benefit are willing to pay</td><td>Cost recovery – unlikely unless one agency leads and all agencies benefit, to the extent they are will to pay</td></tr>
<tr><td>Pooled funding – suitable if the agencies involved are committed and if ongoing transaction costs are low</td><td>Pooled funding – suitable if the agencies involved are committed and if ongoing transaction costs are low</td><td>Pooled funding – unsuited as a large number of agencies implies high transaction costs</td></tr>
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Questions and Feedback

The Treasury can provide advice on the application of the framework and support agencies to work through specific funding issues. Agencies should contact their relevant vote analyst in the first instance.

For broader comments or questions about the framework, please contact Kirsten Jensen, Principal Advisor, The Treasury (kirsten.jensen@treasury.govt.nz).