THE TREASURY
Kaitohutohu Kaupapa Rawa

Public Sector
Financial Management Capability

Executive Summary Report

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1. Methodology

1.1 Overview

A combination of an initial on-line survey followed by qualitative research was adopted for this project. Quantitative research was undertaken initially because The Treasury was specific about the measures it wished to establish which negated the need to undertake qualitative research to inform the design of the quantitative research. Subsequent qualitative research sought to gain understanding of the results from the surveys that were conducted.

1.2 Quantitative research – On-line surveys

Two on-line surveys were developed. One was intended for Chief Executives and the other for Chief Financial Officers of the 42 Departments and Ministries that comprise the public sector to complete. The surveys differed in so far as the Chief Executive's survey was shorter and addressed macro-level issues associated with financial management capability while the Chief Financial Officers' survey included those questions, but also addressed several micro-level issues. The surveys are attached as an appendix to this report.

Chief Executives and Chief Financial Officers were asked to ensure that no conferring occurred within their departments over the completion of the surveys. Thus, if a Chief Executive decided to delegate the completion of a survey to another member of the senior management team, they were asked to ensure the delegation was not to the Chief Financial Officer. This has enabled analysis to be undertaken over any gaps in perceptions between the two surveys where questions are common to both.

The research was conducted between 27 June and 17 July 2008, though three Chief Executive surveys were received after the close-off date and are included in the data. Of the 43 Chief Executive surveys that were sent out, 38 completed surveys were returned representing an 88% response rate. Forty two of the 43 Chief Financial Officer surveys were returned, thus providing a high degree of confidence in the results.

The following page identifies the Chief Executive that completed the survey by type of Department or Ministry characterised by whether they are large or small, operational or policy focused, or whether they have significant non-departmental activity. This typology is used through the tables in this report in order to enable comparisons to be made like with like.

1.3 Qualitative research

The subsequent qualitative research comprised 2 focus groups and 10 one-on-one depth interviews. One focus group was conducted with large Ministries and Departments and the other with small ones recognising the significantly different experiences, challenges and resources available to both. The attendees at the focus groups were Chief Finance Officers. Following the focus groups, 10 one-on-one depth interviews were conducted with Chief Executives from a mix of large and small Departments and

Ministries. The discussion guide and question lines for the interviews are both included in the appendices. In order to preserve the anonymity of respondents, all verbatim quotes used in this report simply ascribe the quotation to either a Large Department/Ministry or a Small Department/Ministry. Where necessary names have also been deleted from quotations to preserve anonymity.

1.4 Participation and responses

The following 43 Departments and Ministries were sent both the Chief Executive and Chief Finance Officers' on-line surveys.

Large Operational Departments with significant non-departmental activity:	Small Operational Departments:
▪ Inland Revenue Department ▪ Ministry of Social Development ▪ Department of Labour ▪ Ministry of Agriculture and Forestry ▪ Ministry of Education ▪ Ministry of Justice ▪ New Zealand Customs	▪ Archives New Zealand ▪ Audit Office ▪ Crown Law Office ▪ Education Review Office ▪ Gov't Communications Security Bureau ▪ Ministry of Fisheries ▪ National Library of New Zealand ▪ New Zealand Food Safety Authority ▪ Office of the Clerk of the House of Representatives ▪ Office of the Ombudsmen ▪ Parliamentary Service ▪ Serious Fraud Office ▪ Statistics New Zealand
Large Policy Ministries with significant non-departmental activity:4	**Small Policy Ministries with significant non-departmental activity:**
▪ Ministry of Economic Development ▪ Ministry of Foreign Affairs and Trade ▪ Ministry of Health ▪ Ministry of Transport	▪ Dept of Building and Housing ▪ Food Safety Authority ▪ Ministry for Culture and Heritage ▪ Ministry of Defence ▪ Ministry for the Environment ▪ Ministry of Research Science and Technology ▪ State Services Commission ▪ Te Puni Kokiri ▪ The Treasury
Large Operational Departments:	**Small Policy Ministries:**
▪ Department of Conservation ▪ Department of Corrections ▪ Land Information New Zealand ▪ New Zealand Defence Force ▪ New Zealand Police	▪ Department of the Prime Minister and Cabinet ▪ Ministry of Pacific Island Affairs ▪ Parliamentary Commissioner for the Environment ▪ Parliamentary Counsel Office ▪ Ministry of Women's Affairs

Responses to the Chief Executives' survey were received from 38 Departments and Ministries. Those that did not respond were the Department of Labour, Ministry of Justice, the Food Safety Authority, the New Zealand Defence Force and the Ministry of Pacific Island Affairs. Responses were received from 42 Chief Finance Officers. The Office of the Clerk of the House of Representatives did not respond as the Chief Finance Officer in question had completed two surveys on behalf of the Parliamentary Service as well as the Parliamentary Counsel Office.

Results of the two surveys are attached to this report and full supplementary tables with key cross-tabulations are in separate reports to reduce the length of this report.

2. Executive Summary

2.1 Overview

The financial management capability in the public sector is uneven and in some areas weak. Across the public sector there is a need to use the finance function far more strategically. This will require a culture change in Departments and Ministries which will need to be led from the top. The finance function needs to be integrated into key decisions and focused on how to derive best value for tax dollars spent including reviews of base-line spending. Changes are also required to address the perverse incentives of the current budget process and end of year 'use-it-or-lose-it' spend. For this to happen, Treasury must also provide the necessary support, advice and clarity about how it expects cost-effectiveness and value for money to be demonstrated. It must see its role not only as a monitor and check on spending, but as having an obligation to help build financial management capability. As adviser to the Minister of Finance and with an ability to work with other central agencies, it is uniquely placed to facilitate greater cross-sectoral co-operation to ensure a more holistic prioritisation of spending.

2.2 Financial management capability

- Departments and Ministries struggle to attract the management accounting expertise they need. This suggests capability may well be short of what is needed to implement a more strategic approach to financial management.

- Departments and Ministries report that most of their finance resource is allocated to meeting compliance requirements leaving little capacity for providing added-value financial advice and support.

- Beneath the level of Chief Finance Officer there are some significant knowledge gaps and Chief Finance Officers have been de-layered down to third and fourth tiers in organisations in recent years.

- Only a minority of Chief Executives (39%) and Chief Finance Officers (40%) are satisfied that their Department or Ministry has the necessary financial and operational performance information to adequately inform and manage change over the next three years.

- Only half (50%) of Chief Financial Officers say their Departments or Ministries use internal financial reporting processes to either reinforce a culture of cost consciousness and waste avoidance or to identify for reprioritisation to better meet objectives. Less than half (43%) say they are used for making efficiency gains.

- One-third (31%) of Departments and Ministries did not hold an audit committee or equivalent meeting in the 12 months to 30 June.

- 19 different financial management systems are used across 42 different Departments and Ministries and almost one-third (29%) of these are near the end of their life.

2.3 Lack of clarity about financial management information

- Departments and Ministries struggle with how to measures cost-effectiveness and value for money. Such measures would seem to be fundamental to informing strategic financial management decisions.

- There appears to be little direction given by The Treasury as to what the appropriate measures of cost effectiveness and value for money are. Neither does it appear to provide information on best practices and systems to improve financial management in the public sector.

- Only a minority of Chief Executives rated the financial function's contribution highly in the following areas:

  - Setting organisational priorities (24%)
  - Outsourcing or use of shared service centres (29%)
  - Developing long-term business strategy (37%)
  - Review of policy proposals prior to senior management team review and Ministerial submission (42%)

- Only a small majority of Chief Executives identify the finance function as making a high contribution in these areas:

  - Risk management (55%)
  - Reallocation decisions (58%)
  - Controlling costs (61%)
  - Negotiations with major suppliers (61%)
  - However, 71% say the function makes a high addition to capital expenditure decisions

- A significant majority rated the following reasons as important or moderately important (1-3 on a 1-5 scale) barriers to improving finance management in their departments:

  - Too much focus in the public sector financial system is on the short-term i.e. the annual appropriation (86%)
  - Poor financial awareness among non-finance staff (84%)
  - Difficulties in finding, training and retaining suitably skilled and qualified finance staff (81%)
  - A lack of incentive to encourage senior budget holders to improve financial management in the management of departmental programmes (74%)
  - Inadequate operational performance management and management accounting information on which to base future resource allocation decisions (74%)
  - Business process which have not been reviewed for some time, and which do not fit the current requirements of the organisation (71%)

- Senior managers need to be conscious of the need to include the finance function early in their decision-making processes and to clearly articulate the critical information it requires.

- Equally, there is an onus on the finance function to design its systems and the information it provides in a way that is easily understood and useful to managers.

2.4 Forecasting

- Over one-third of Chief Executives agree that their budget process produces forecasts that do not accurately predict future results and half of Chief Finance Officers say it is desirable to have greater central agency guidance and support to improve forecasts.

- Almost half Chief Finance Officers agree that in their budgeting process, managers fight hard to protect "their" resources and always try to spend what's in their budget.

- There is also a strong culture among managers to over-forecast the money they require in the budget process because of the fear that if they under-spend they will lose that money in the future. This can lead to forecast spending being significantly under-spent in some areas and as a consequence surplus money is spent on lower priority programmes.

- There are concerns that the full long-term cost-benefits analysis of new programmes is not sufficiently rigorous.

- A critical financial risk for Chief Executives over the next three years is 'pressure from Ministers to change plans/directions' (56% rated this moderate to high) and 'management of conflicting priorities' (76% rated this moderate to high). Conflicting priorities primarily refer to the tensions between Ministerial decisions alongside issues such as managing day-to-day cost escalations and maintaining a focus on long-term goals with the former two impacting on the ability to do the latter.

- Ministers seem inclined to think that Departments and Ministries have the ability to absorb their non-budgeted initiatives and this seems to be a more common experience for large ones where it is assumed that because they have a large budget they have a capacity to absorb more which is not always the case. This can lead to the dilution of outputs and low quality spending in the case of some political decisions that are made.

- Ministers are reluctant to trade-off existing programmes for new initiatives. If more thorough cost-benefit analysis could be provided to Ministers a more convincing case for ceasing low quality programmes could be presented.

2.5 Quality of spending – savings, cost-effectiveness and value for money

- If it is assumed that the ability to identify savings is a key indicator of whether Departments and Ministries are identifying ways of being more cost effective and providing value for tax dollars spent, then it must be a concern that among Chief Executives 37% (CFOs 45%) identified as a barrier to the optimal use of savings during a year the uncertainty over whether/how much savings will occur.

- 39% of Chief Executives identified as a barrier to make savings over multi-years that there were no incentives to identify or use savings.

- Only 34% of Chief Executives said they used internal financial reporting processes extensively to identify opportunities for making efficiency gains.

- One-third of Chief Executives agreed with the statement that 'our budgeting process does not generate sufficient information to assure management that we make the best prioritisation decisions', 29% are neutral and 39% disagreed with that statement.

- Policy Ministries appear to face more of a challenge in establishing systems to effectively measure the full cost and value for money of activities. Some see a need to introduce time reporting systems where none exist at present.

- Only a minority of Chief Finance Officers said they frequently include alternative options detailing comparative data on expected costs and operational impact (29%) and the main factors driving costs, income and outputs, together with a quantification of the impact of different scenarios (40%).

- To ensure the foundation for quality spending decisions, high-level, cross-sectoral discussions at the Ministerial level need to occur, informed by Chief Executives, to determine strategic priorities for spending. Sector Chief Executives should then work collegially across departments in that sector to ensure the most effective spending decisions are proposed for Ministers to consider. This might lead to a greater ability to move money across Votes to achieve the most effective spend, as well as the development of complementary initiatives between Departments.

- Budget bids would need to be scrutinised against this framework which would establish clear criteria for prioritising spending.

2.6 Base-line reviews

- The strong culture that current base-line spending needs to be maintained year-on-year provides little incentive to review base-lines and the quality of spend that is occurring.

- Rigorous review of base-lines may identify low quality spending. It may also lead to undertaking programmes in more effective ways, for example, by using technology to enable better processes.

- There is a desire for Treasury to place more emphasis on Departments and Ministries to conduct base-line reviews.

- The benefit of a base-line review that examines fundamentals is that it will enable Departments and Ministries to be in a better position to enable savings to be identified and spending priorities made.

2.7 Budget culture

- The view that this year's spend is required for next year without any supporting financial analysis is pervasive and exacerbates a budget process that does not have a focus on base-line expenditure, which accounts for the vast amount of money that is appropriated, but on the allocation of new money.

- One-third of Chief Executives (32%) agreed that their budget processes does not generate sufficient information to assure management that it makes the best prioritisation decisions and only 39% disagreed.

- A quarter of Chief Executives (26%) agree that the annual budget process takes too long, costs too much and provides little of value and only a minority (45%) disagree.

- Only a minority (47%) of Chief Executives disagree that their budget process produces forecasts that do not accurately predict future results.

2.8 Efficiency incentives

- Treasury needs to signal greater clarity about its preparedness to accept transfers across Votes and appropriations and across years as a general rule, and if so, to be consistent about the process it adopts in evaluating proposals to make transfers.

- If more flexibility is to be introduced to manage finances, then the requirement to evaluate spending in order to demonstrate the value for money that will result should be more pressing. This once again emphasises the need for clear and consistent measures of value for money to be used and for the finance function to be used more strategically than appears to be the case at present.

- Departments and Ministries should consider the use of internal league tables and Treasury cross-departmental league tables to encourage greater efficiency. This again is dependent upon clear and consistent measures being applied.

2.9 Departments with significant non-departmental expenditure

- There is considerable variance in the extent of control that Departments and Ministries with significant non-departmental expenditure exercise over that spending.

- Some Departments/Ministries where legislated, delegated independence for third parties exists have limited leverage to manage what they perceive as significant risk.

- To better manage these perceived risks, Departments and Ministries with significant non-departmental expenditure will need to be clearer about accountability expectations and monitoring. There is no desire though to see a reversion to direct, centralised control.

- In some instances, where risks are transferred to agencies that report to another Minister and there is a difference of view about the risk, issues need to be drawn to Ministers attention to be resolved.

2.10 Relationship with Treasury

- Departments and Ministries do not regard Treasury as a neutral adviser to the public sector. Rather, it is seen as focused on a monitor of spending.

- Treasury needs to work on developing a more transparent and trusting relationship with Departments and Ministries.

- A more trusting and open relationship will make it easier to manage situations around the annual under-spend and what happens to that money. Conversely, having a poor relationship created the wrong incentives.

- A more trusting and open relationship is required if Treasury is to provide the advice and support required to raise financial management capability across the public sector.

2.11 Recommendations for Treasury

- Treasury should establish a unit to provide analytical and advisory services to Departments and Ministries to improve their financial management capability. This could involve the role of identifying best practices both internationally and within the public sector and disseminating them as a trusted advisor.

- Such a unit having the capability on request to undertake an analytical audit of financial management and the ability to make recommendations.

- Treasury should facilitate short-term secondments across Departments and Ministries and knowledge sharing of financial management systems.

- Treasury should seek with the approval of the Minister of Finance a more collaborative approach across Ministers and Departments/Ministries with a view to establishing agreed priorities and optimising spend across sectors.

- Treasury should play a more active role in signaling priority spending areas early in the budget round. In these ways, Treasury could also play an active role in closing the gap between Ministerial expectations and departmental capability.

- Review with other central agencies how the alignment of public sector goals, for instance, the requirement for joined-up services sits against a budget system that provides incentives for individual Departments and Ministries to retain current appropriations.

- Treasury should provide clear guidance on how value for money and cost effectiveness should be measured across the public sector.

- Treasury to more directly encourage financial efficiencies. If consistent measures of value for money can be provided, then it would be possible to establish score-cards across Departments and Ministries of similar scale to engender a culture of efficiency

- Treasury should consider reviewing compliance requirements with a view to streamlining them where appropriate to release what seem to be scarce resources to raise financial management capability.

- Treasury should play a role in meeting longer-term capability issues by using its influence, for instance, to encourage the development of public sector financial management courses, such as, with Victoria University's School of Government

2.12 Recommendations for Departments and Ministries

- Chief Executives need to lead a cultural change to drive cost efficiencies and value for money across the public sector. There is a need for quality financial information to be integrated into key operational and policy decisions.

- Chief Executives should consider establishing financial assurance or advisory committees to provide the support they may need.

- Departments and Ministries can play their part by being recognising the Chief Finance Officer's role and ability to contribute strategically and by being prepared to allocate resources to raise financial management capability.

- Departments will need to develop a strategic framework and the systems within which finance function can add value.

- Flowing from that comes the need for Departments and Ministries to ensure:

    - The finance function has a voice at the senior management table
    - Senior managers clearly articulate the strategic finance information they require
    - Policy and finance work closer together and earlier on proposals
    - Finance provides the right information in an easily understood way to support managers to make financial management decisions

    This may require managers to be provided with some financial management training. And time costing measures should be considered, but this needs to be positioned on the premise that they are there to inform resource allocation not to check up on people, so there can be buy-in.

- Departments and Ministries need to play their part to address the perverse 'use-it-or-lose' mentality that exists. Silo cultures should be broken down to ensure there is understanding and buy-in to the Department or Ministry's long-term strategic goals and how these support Government's over-arching goals. In this way, managers may have more incentive to strive for efficiencies that contribute to high-level strategic goals as opposed to individual programmes for which they are responsible.

- Flowing from this and consistent with the need for more challenge to base-lines, Departments and Ministries should be asking the fundamental questions – "should I be doing what I currently do? Is there a better way of doing it?" It may help this process by splitting the budgeting and forecasting processes, so future spend is not necessarily linked to what is important about current spend.