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## **FINANCIAL REPORTING – IMPROVEMENT REQUIRED IN MONTHLY VARIANCE REPORTING**

### **Introduction**

The aim of this circular is to seek your assistance in increasing the quality of variance reporting sent to Treasury. While there has been an increase in the accuracy of expenditure forecasts provided to Treasury, the same is not true for variance reporting.

The key points in this circular are:

- The general quality of the explanations provided for material variances between forecasts and actual results has been poor;
- Plain language explanations for material variances need to be provided to Treasury at the same time as the monthly financial reporting; and
- Treasury will be instituting formal feedback aimed at increasing the quality of variance explanations to the required standard.

### **Variance reporting is important because:**

- It provides feedback for internal and external stakeholders, enabling actual results to be compared against original expectations;
- Legitimate variances that arise can provide information about changes in the environment, providing opportunities to respond and to change future plans;
- It can reveal errors in actual results in time for them to be corrected; and
- It can reveal errors in forecasts that can then be remedied in future forecasts.



## **Key issue**

Although we have seen an increase in the accuracy of the expenditure forecasts sent to Treasury, when forecasts have not been accurate the general quality of the explanations provided for variances has been poor.

### **The common deficiencies with the variance reporting received by Treasury have been that reports have been:**

- Late – fewer than 20% of reports for June were received within the deadline;
- Incomplete – not all of the material variances are explained;
- Superficial – the explanations rarely address the underlying driver(s);
- Not understandable – language is used (especially acronyms) that is not meaningful to someone unfamiliar with your business; and
- Avoidable – we commonly see variances reported because insufficient care was taken to ensure balances were treated consistently and appropriately between forecast and actual exercises.

Based on the quality of the variance reporting we are seeing, my sense is that the level of care taken to prepare robust forecasts and the level of attention given to understanding and communicating reasons for variances has generally not been sufficient.

## **New Feedback Process**

Treasury will be implementing a more formal feedback process in 2009/10 with the aim of increasing the quality of variance reporting to the required standard. Essentially, we will be assessing and rating the quality of variance reports against criteria outlined in Treasury Circular 2007/12. That circular introduced formal variance reporting and outlines our expectations about the content and quality of these reports.

The relevant details of this rating process are in Appendix A.

The first feedback will occur in December 2009 and will cover the variance reports received for the Sep, Oct and Nov months. The feedback for these first three months will not be shared with other entities, unlike the feedback for subsequent months.

A sample feedback report is included in Appendix B.

We are also looking at what we can do to improve the functionality of CFISnet to make it easier to complete variance reports. Some enhancements have already been made and these are covered in Appendix A.

**Action**

In these times of increased fiscal restraint, it is even more important to ensure that financial reporting and forecasting is receiving due care and attention.

Please ask your staff to refamiliarise themselves with the requirements of TC 2007/12, in particular that the variance explanations sent to Treasury need to be understandable and address the underlying drivers of the variances.

We hope that the feedback we provide will help you achieve a better standard of reporting.

Many thanks

Peter Bushnell  
Deputy Secretary to the Treasury

## APPENDIX A – STANDARD OF EXPLANATION REQUIRED

The assessment and rating of variance reports will be based on the expected characteristics outlined in TC 2007/12.

Characteristic	Weighting	Required Standard
Explained	50%	The variance explanation is meaningful and addresses the underlying driver(s)
Timely	15%	The report is submitted on time. The deadlines are the same as for the relevant actuals exercise
Complete	15%	All qualifying variances above the materiality thresholds are explained in the first version of your report that you submit to Treasury
Year End Impact	10%	The explanation identifies the expected impact on your year end results
Dataload lines referenced	10%	The significant component parts of a variance, that qualifies for reporting, are correctly referenced

Depending on the result of our assessment, each monthly report will be rated as Good, Fair or Poor and this will be fed back to entities on a quarterly basis. More details are provided in Appendix B.

Entities that do not have qualifying variances in any particular month will not be rated in that month.

### Tips

Examples of suitable explanations are provided in TC 2007/12. They explain to what the variance relates and why the variance occurred, including an estimate of the year end impact. For example:

Explanation	Year End Impact
-\$170m Centenary concert has been cancelled, resulting in reduced revenue and expenses from the event. Expect to have lower than forecast future revenues/expenses as a result of cancellation.	-\$400m
+\$350m Sponsorship for the Good Times annual awards received earlier than expected (was expected in October).	Nil

The following examples (which we have seen on a regular basis) are not suitable:

Explanation	Why it is Unsuitable
"Timing difference"	It is not enough to attribute a variance to a timing difference without further explanation. What specific transaction was delayed, why was it delayed and when is it now expected to happen?
"The forecast was wrong"	Why was it wrong? If it was an error, what was the nature of the error and has it been fixed for next time? If events unfolded differently to those expected, what events were they and why did they not happen as expected?
"Expenditure was higher than forecast"	This is the definition of a variance, not an explanation for the variance arising.

## **CFISnet Enhancements**

We are also looking to make the variance reporting process easier for users. We have included a feature in the review and lock stage of the data submission process that will automatically identify the variances that qualify for reporting. We have also provided links from the review and lock page to your data schedules and the variance report template.

These enhancements were introduced at our recent CFISnet User Group meeting and are being rolled-out in time for your September actuals submission.

## APPENDIX B – SAMPLE FEEDBACK

On the next page there is a sample of the feedback we will provide to all entities from March 2010.

Reports will be rated as Good, Fair, or Poor based on our assessment of the characteristics listed above. Our assessment will be based on the following system:

- 2 points will be awarded for each characteristic, based on the extent to which the required standard is met\*:
  - 2 points for achieving a high standard;
  - 1 point for achieving a moderate standard; and
  - No points for a low standard.
- A weighted average will then be taken of the points awarded for each characteristic, based on the weightings listed in Appendix A.
- Each month's report will then be rated as:
  - Good for a weighted average greater than or equal to 1.5;
  - Fair for a weighted average greater than or equal to 1.0; or
  - Poor for a weighted average less than 1.0.

\* While we have tried to develop an objective rating system some level of subjectivity is inevitable. We expect to refine our assessment system as our experience develops. For this reason, the feedback relating to the first quarter will not be shared with other entities. It is only the results of the 2<sup>nd</sup> and subsequent quarters that will be shared in this format.

The feedback will also include details on how reports measured-up with respect to each of the characteristics. This should help identify where any improvement may be required.

**APPENDIX B – SAMPLE FEEDBACK (CONTINUED)**

**Variance Reporting Leaderboard - Quarter Ending 30 June 2009**

April	Entity	Result	
1	A	Good	2.00
2	B	Good	1.80
3	C	Good	1.80
4	D	Good	1.75
5	E	Good	1.70
6	F	Good	1.50
7	G	Fair	1.40
8	H	Fair	1.30
9	I	Fair	1.25
10	J	Fair	1.15
11	K	Fair	1.00
12	L	Poor	0.80
13	M	Poor	0.80
14	N	Poor	0.70
15	O	Poor	0.60
16	P	Poor	0.60
17	Q	Poor	0.50
18	R	Poor	0.45
19	S	Poor	0.40
20	T	Poor	0.30

**Assessment**

This leaderboard provides feedback on the quality of variance reports supplied by Crown reporting entities. The quality is assessed against the following criteria, taken from Treasury Circular 2007/12:

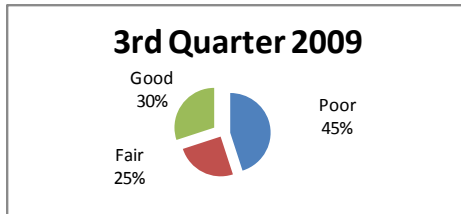
- Complete reporting
- Timely submission
- Explained and meaningful
- Year end Impact identified
- Dataload line correct

The results and rankings for each month are shown in the lefthand column.

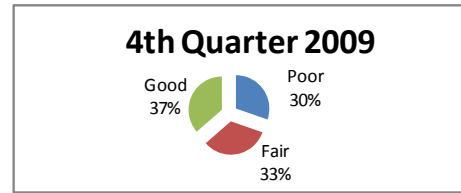
**Overall Quality**

There were 66 variance reports submitted by entities during the quarter ended 30 June 2009. Of these, 24 were assessed as "good", 22 were "fair" and 20 were "poor".

**Quarter ended 31 March 2009**



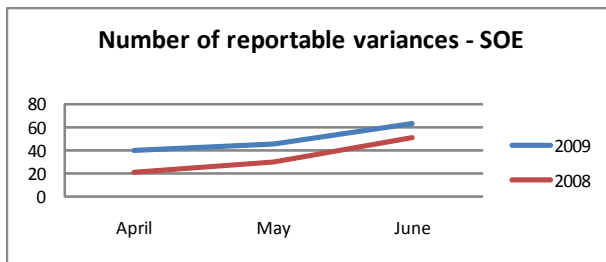
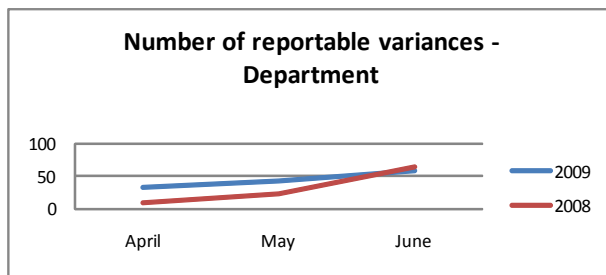
**Quarter ended 30 June 2009**



May	Entity	Result	
1	A	Good	2.00
2	B	Good	2.00
3	C	Good	1.85
4	D	Good	1.75
5	E	Good	1.60
6	F	Good	1.50
7	G	Good	1.50
8	H	Fair	1.45
9	I	Fair	1.45
10	J	Fair	1.30
11	K	Fair	1.30
12	L	Fair	1.30
13	M	Fair	1.30
14	N	Fair	1.20
15	O	Poor	0.85
16	P	Poor	0.80
17	Q	Poor	0.60
18	R	Poor	0.15

**Reportable variances**

This section shows the total number of variances that required reporting each month. The highest number of reportable variances in any one month was 71, in June 2009. We hope to see the number of reportable variances reduce, as entities improve the quality of their forecasting.



June	Entity	Result	
1	A	Good	2.00
2	B	Good	1.85
3	C	Good	1.70
4	D	Good	1.70
5	E	Good	1.70
6	F	Good	1.70
7	G	Good	1.60
8	H	Good	1.55
9	I	Good	1.50
10	J	Good	1.50
11	K	Good	1.50
12	L	Fair	1.35
13	M	Fair	1.35
14	N	Fair	1.35
15	O	Fair	1.20
16	P	Fair	1.20
17	Q	Fair	1.20
18	R	Fair	1.10
19	S	Fair	1.00
20	T	Fair	1.00
21	U	Fair	1.00
22	V	Poor	0.80
23	W	Poor	0.70
24	X	Poor	0.65
25	Y	Poor	0.50
26	Z	Poor	0.50
27	AA	Poor	0.50
28	AB	Poor	0.20