# ADMINISTRATIVE AND SUPPORT SERVICES BENCHMARKING REPORT

## FINANCE PERFORMANCE FINDINGS
## FY 2011/12

# Contents

# 1. COMMENTARY

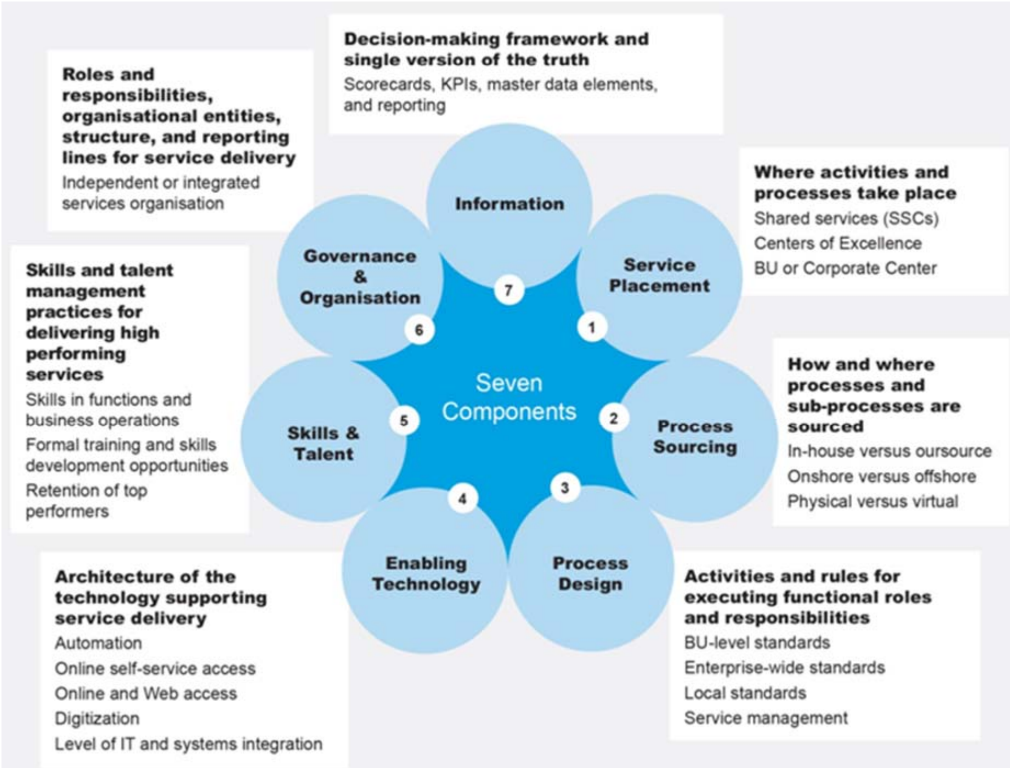
By Fergus Welsh, Chief Financial Officer and Chief Accountant, Treasury

# Commentary

**More than ever before, the public sector finance community has a common understanding of its performance gaps, their root causes, and what must be done next**. BASS, the recent Auditor-General's discussion paper*, and process-level benchmarking across 18 agencies have supported frank, evidence-based discussions about finance function performance and the imperatives for improvement. The three imperatives are better processes and leveraging technology, enhanced people capability, and stronger senior leadership demand for finance excellence.

**The Optimise Finance programme will address two imperatives: better processes and enhanced people capability.** In its first stage, the programme will involve a limited number of agencies exploring and providing recommendations for a new service delivery model for finance that looks at all seven components of service delivery as outlined in Figure 1. The most important change levers will be skills and talent, service placement, and process design; with the latter two focused on optimising the use of existing technology. Later programme stages will explore ways to share the model across a larger number of agencies.

Figure 1: Components of a Service Delivery Model




Source: Hackett Group

*Controller and Auditor General, *Reviewing financial management in central government*, June 2012.

# Commentary

**The third imperative is to establish stronger demand for better financial management.** In leading practice organisations, chief executives establish a financial management culture that emphasises cost consciousness, effective allocation, use of performance metrics, and value creation. My CFO colleagues, the Better Public Services (BPS) Advisory Group, and the Auditor General have called for stronger financial management leadership in agencies and from their Chief Executives. Central agencies have an ongoing role to play in setting expectations, accountability, and incentives for strong financial management practice across government.

**This year's BASS report shows year-on-year improvements in spending since the first report in FY2009/10 and opportunities for even greater gains in the years to come.** If these are through efficiencies, then public sector finance professionals have some joint achievements worth celebrating. This report shows steady incremental improvement in cost, efficiency, and effectiveness of the finance function since the first report in FY 2009/10. More importantly, we anticipate a further jump in performance through cross-agency improvement projects like *Optimise Finance* and the ongoing work to strengthen strategic finance across the public sector.

I look forward to seeing the impact of our finance function improvement work in future BASS results.

# 2. HIGHLIGHTS

# Highlights

**Agencies reported spending $12.8 million less than FY 2009/10 when adjusted for inflation, a reduction of 10.3 percent. $4.4 million reflects a reduction from this reporting period.** Agencies that experienced the largest cost reductions cited restructuring, process improvements, and reduced spending on consultants and contractors.

**Agencies reported efficiency gains over the three reporting periods, but there are still opportunities for improvement.** Agencies continue to benchmark well against international comparators for efficiency, but there is an opportunity to make up to $20.7 million in further gross savings each year if agencies reduce spending on the Finance function as a percentage of organisational running costs (ORC) to their cohort upper quartile.

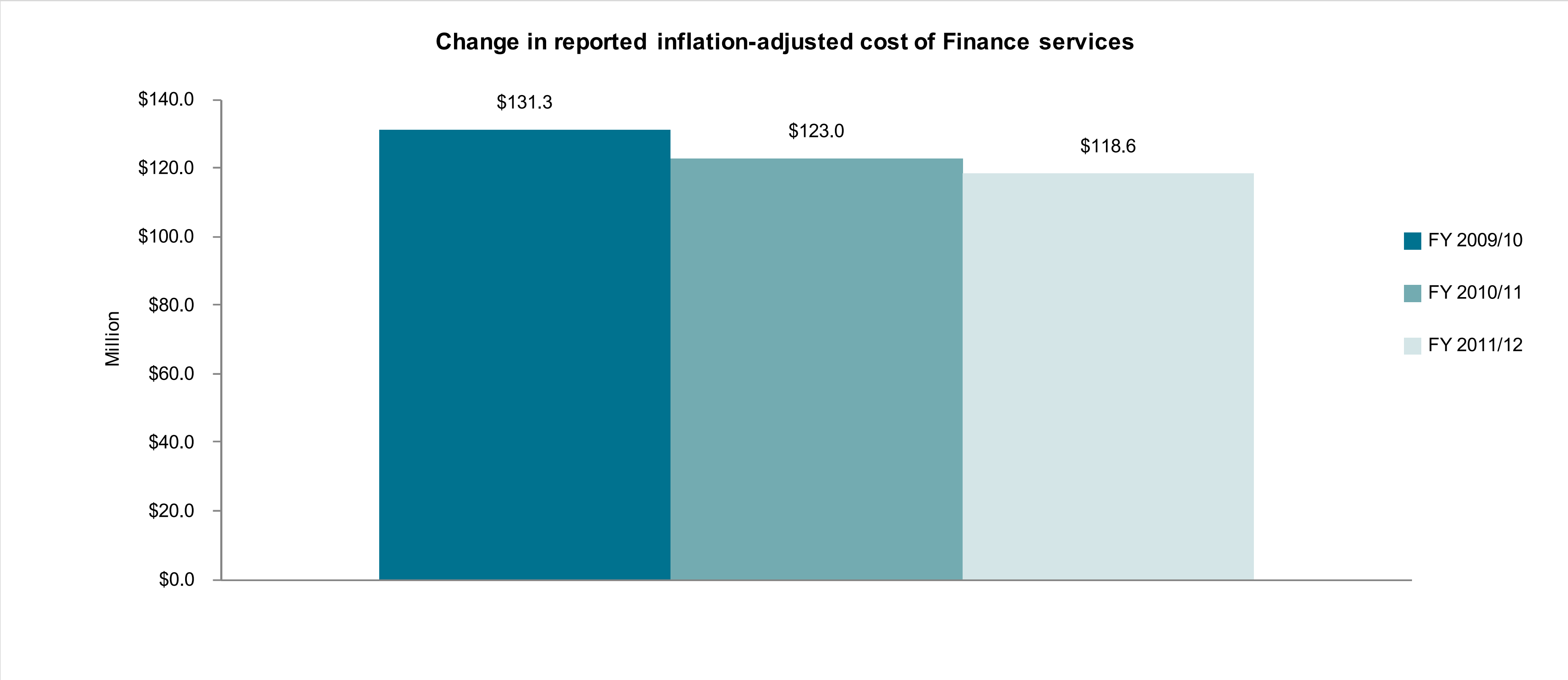
**The cost and efficiency of the Finance function should be assessed in light of its effectiveness and business value.** Given the importance of the Finance function performance to overall agency performance, a low cost Finance function is not attractive unless it meets agency requirements and value for money expectations. Having agencies (not just the Finance function) better understand this relationship contextualises the Finance function within the wider organisation and its ambitions. It is one of the areas to be reinforced through the *Strengthening Strategic Finance* project.

**Finance management practices lag international comparators and have aspirations to improve.** The introduction of the Finance Capability Maturity Model (CMM) for FY 2011/12 will provide a stronger basis for monitoring capability improvement than the previously used MPI. The two highest priority areas for improvement across the NZ agencies are: historical versus proactive forward looking reporting and analysis; and forecast timeliness, accuracy, and usefulness.

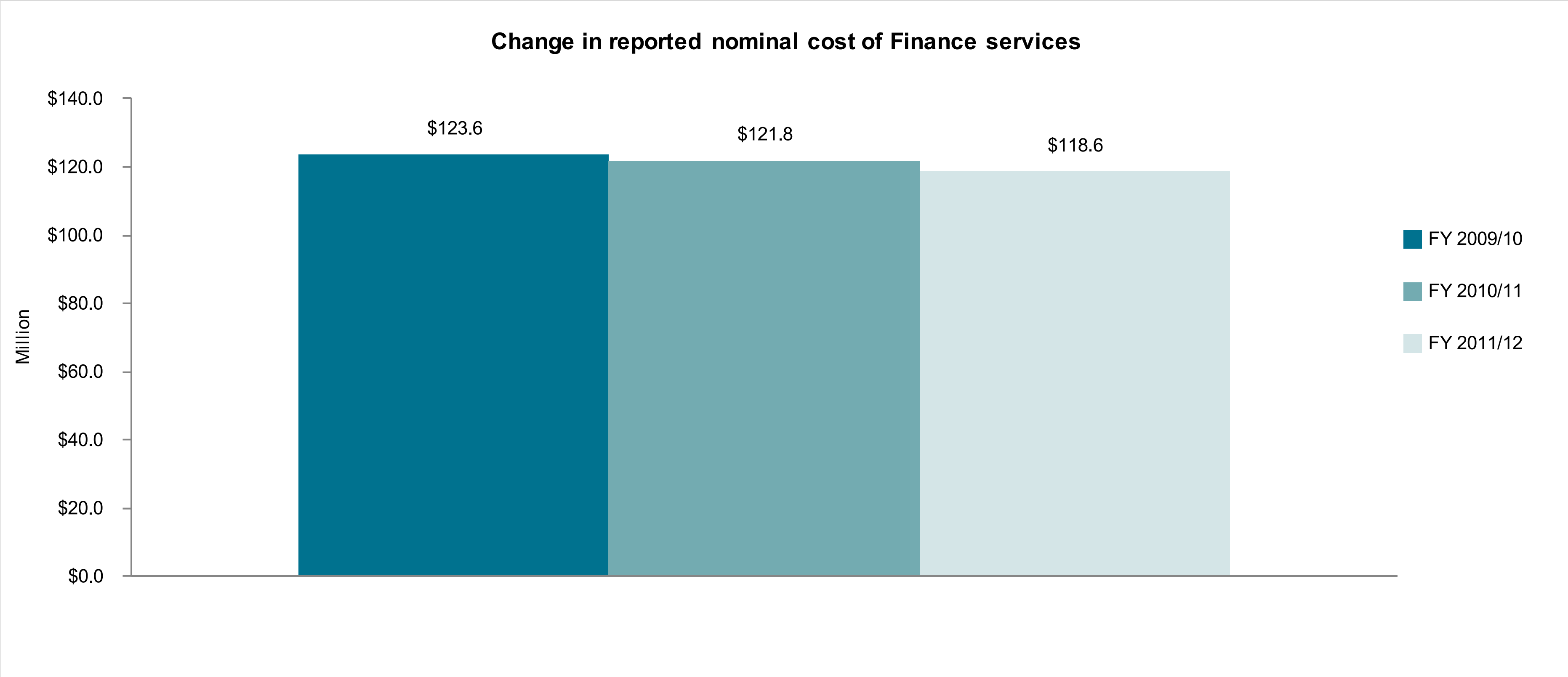
# 3. COST

Cost findings include total spending overall and by agency cohort. This section also provides information about changes in spending since the previous reporting period both in nominal and inflation-adjusted terms.

# Agencies spent $118.6m on the Finance function in FY 2011/12, down $12.8m (or 10.3 percent) from FY 2009/10 when adjusted for inflation



# Agencies reported a nominal spending reduction of $3.3m (or 2.7 percent) in FY 2011/12



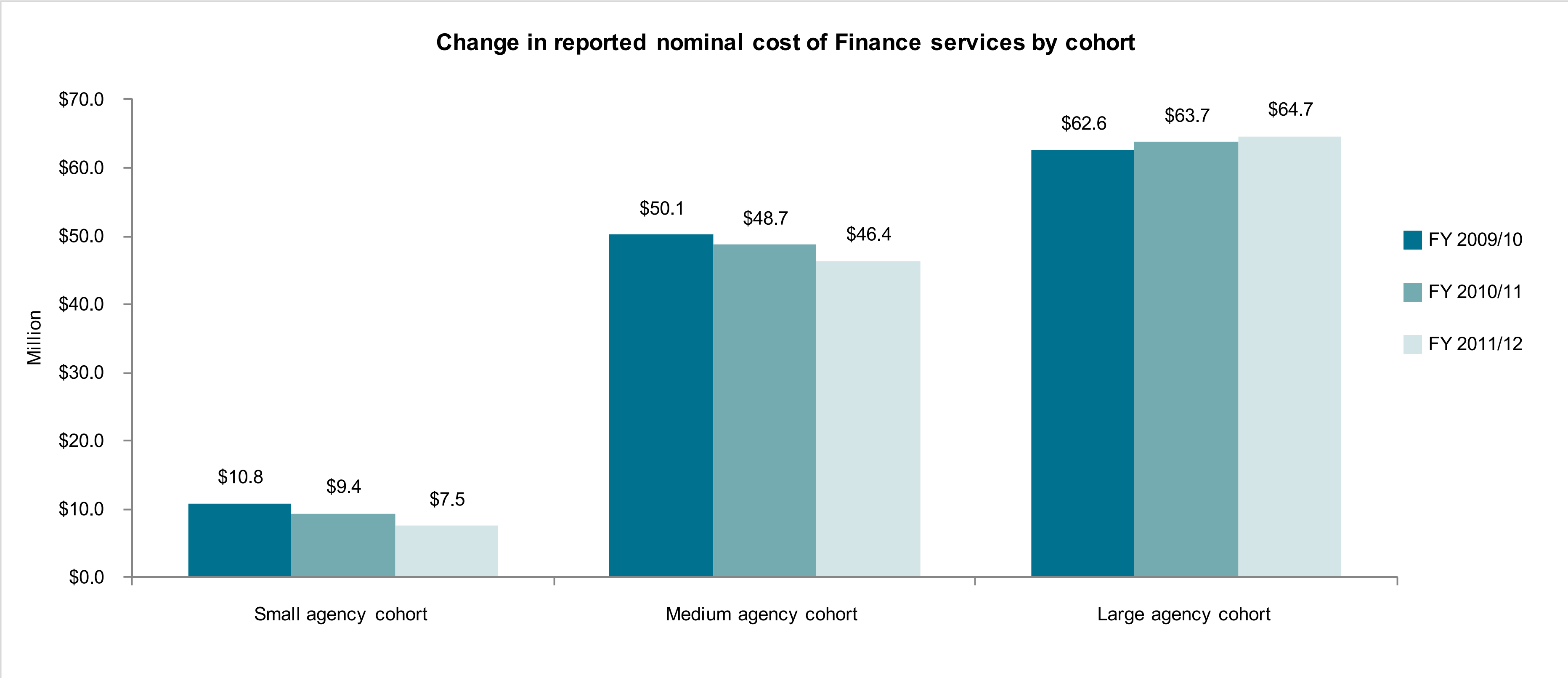
## A net spending reduction of $3.3m results from 17 agencies spending $6.9m less and 12 agencies spending $3.6m more than in FY 2010/11

Three agencies contributed $3.9 million to the overall reduction.

Reduced personnel costs as a result of finance and organisation-wide restructuring, process improvement, and reducing spending on consultants and contractors were cited as key contributing factors by those agencies that reported the greatest reductions.

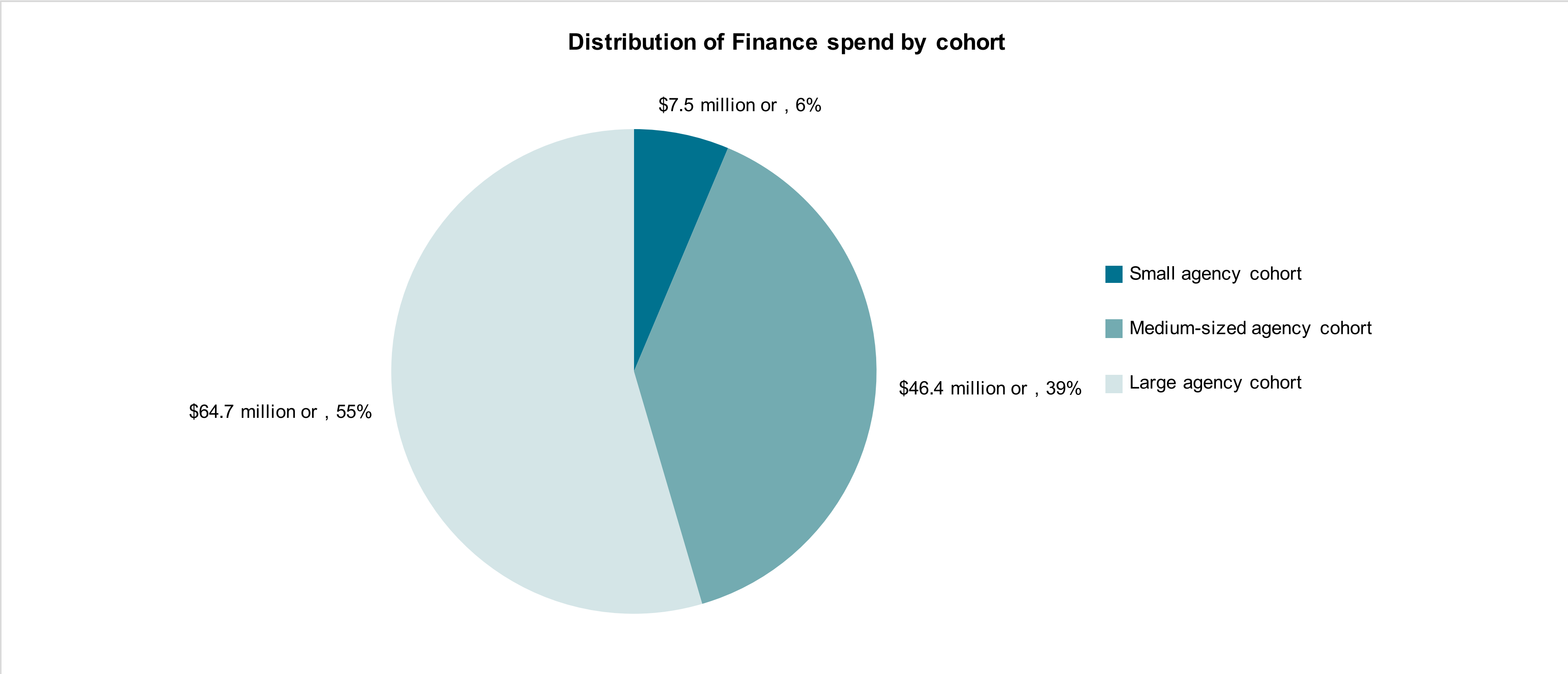
Two agencies contributed an increase of $2.4 million. These agencies cited reasons including: absorption of a new function within the organisation, a review of the Finance function, and special one-off projects. The other 10 agencies spending more on Finance reported a median increase of $0.1 million.

# The small and medium-sized agency cohorts have reported year-on-year reductions in Finance service expenditure

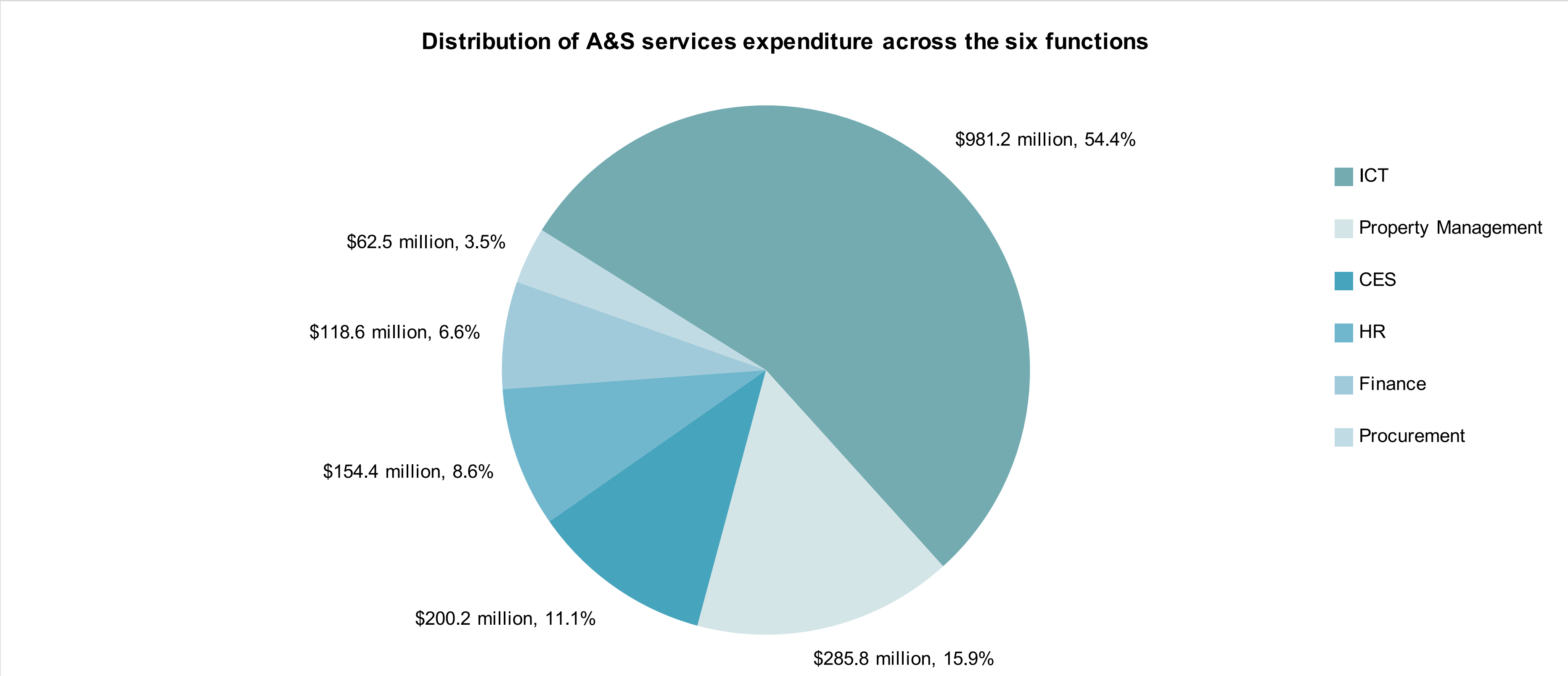



It is likely that latent cost pressure will be building up for some agencies, so it will be interesting to see if this trend continues. Transformation is usually required in order to see significant and sustained cost reductions.

# The medium-sized and large agency cohorts make up 93.6 percent of reported Finance service expenditure



# Finance makes up 6.6 percent of A&S service spending, making it the fifth largest function by reported expenditure

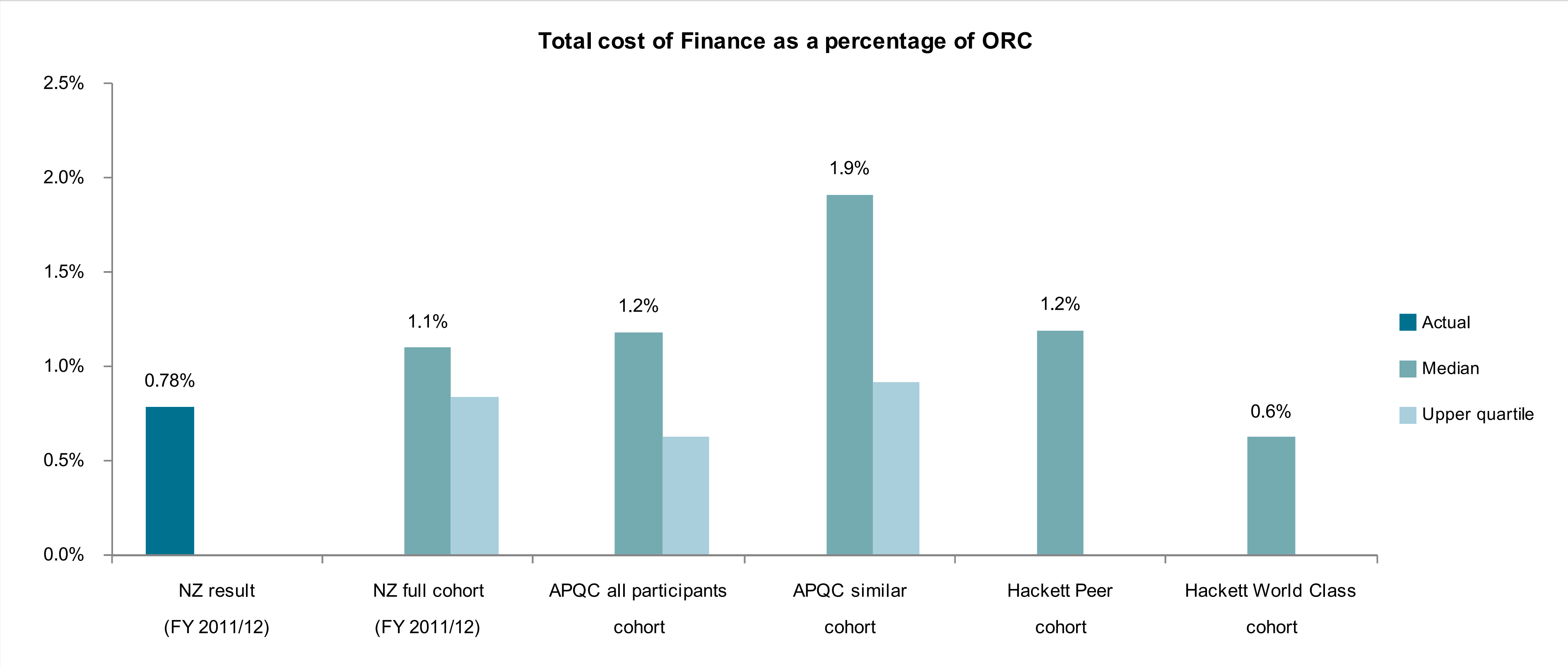


# 4. EFFICIENCY

Efficiency findings report on the ratio of input to output (or the use of resources in a manner that minimises cost, effort, and time) as well as opportunities for efficiency gains and their implications for gross savings. This section also compares cohort efficiency with international comparators (American Productivity and Quality Center (APQC) and The Hackett Group) and examines changes in efficiency since previous reporting periods.

Efficiency findings are based on one metric: the total cost of Finance as a percentage of ORC, where a lower cost is considered more efficient.

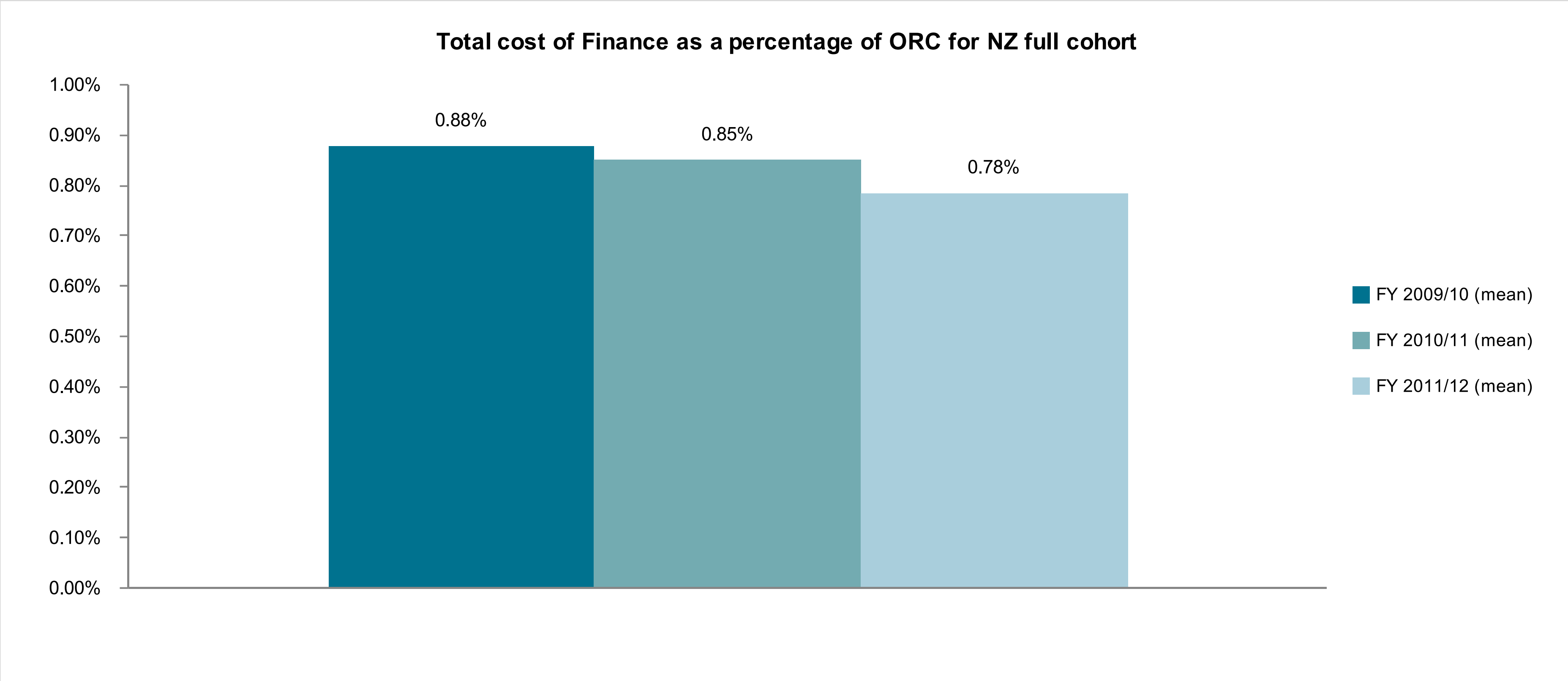
# The cost of Finance as a percentage of ORC is strong against international benchmarks, but there are reasons to be cautious when assessing this comparison




Other studies of the Finance function raise questions about the actual relative efficiency for two reasons:

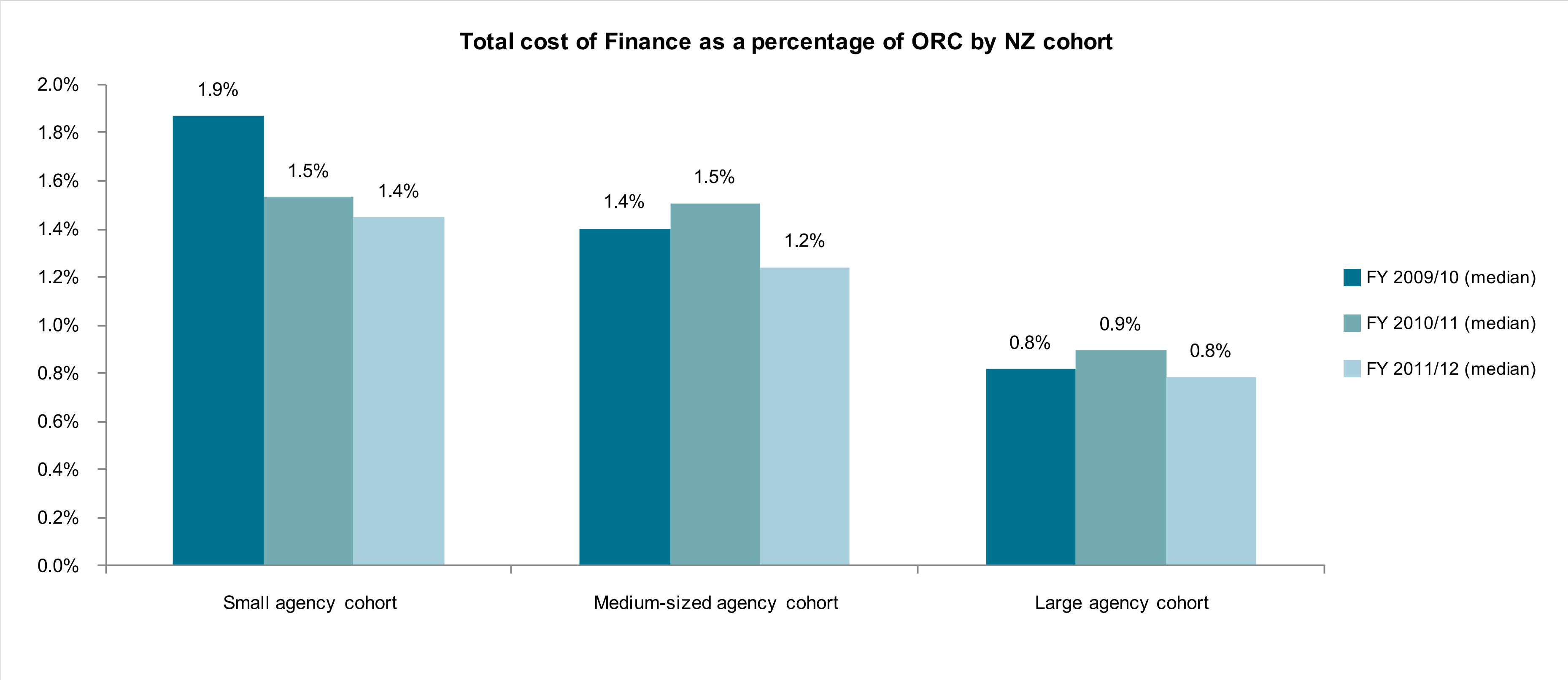
1. In many agencies, the strategic end of the finance function is not being performed effectively, and these activities are being completed (and costed) for international comparators
2. NZ remuneration for the finance function is 40 percent lower than in the international comparator organisation countries, which has a material impact on the efficiency findings

# Agencies demonstrate steady incremental efficiency improvement



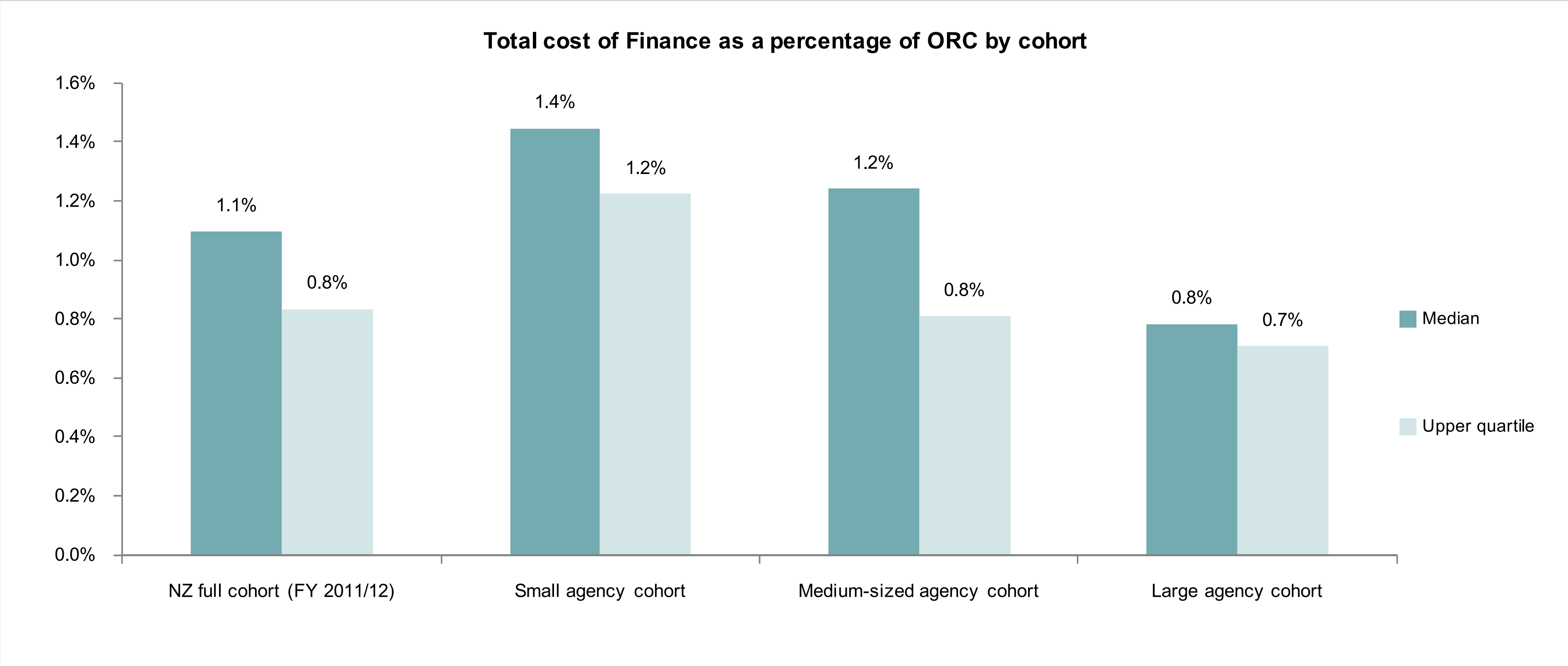

While spending on the Finance function has reduced, the year-on-year increase in reported ORC has contributed to the reported efficiency of the Finance function. If ORC remained constant between FY 2009/10 and FY 2011/12, reported efficiency in FY 2011/12 would be 0.84%.

# Efficiency gains since FY 2009/10 can be seen in each cohort




The small agency cohort has demonstrated the greatest reduction in the reported cost of finance function as a percentage of ORC.

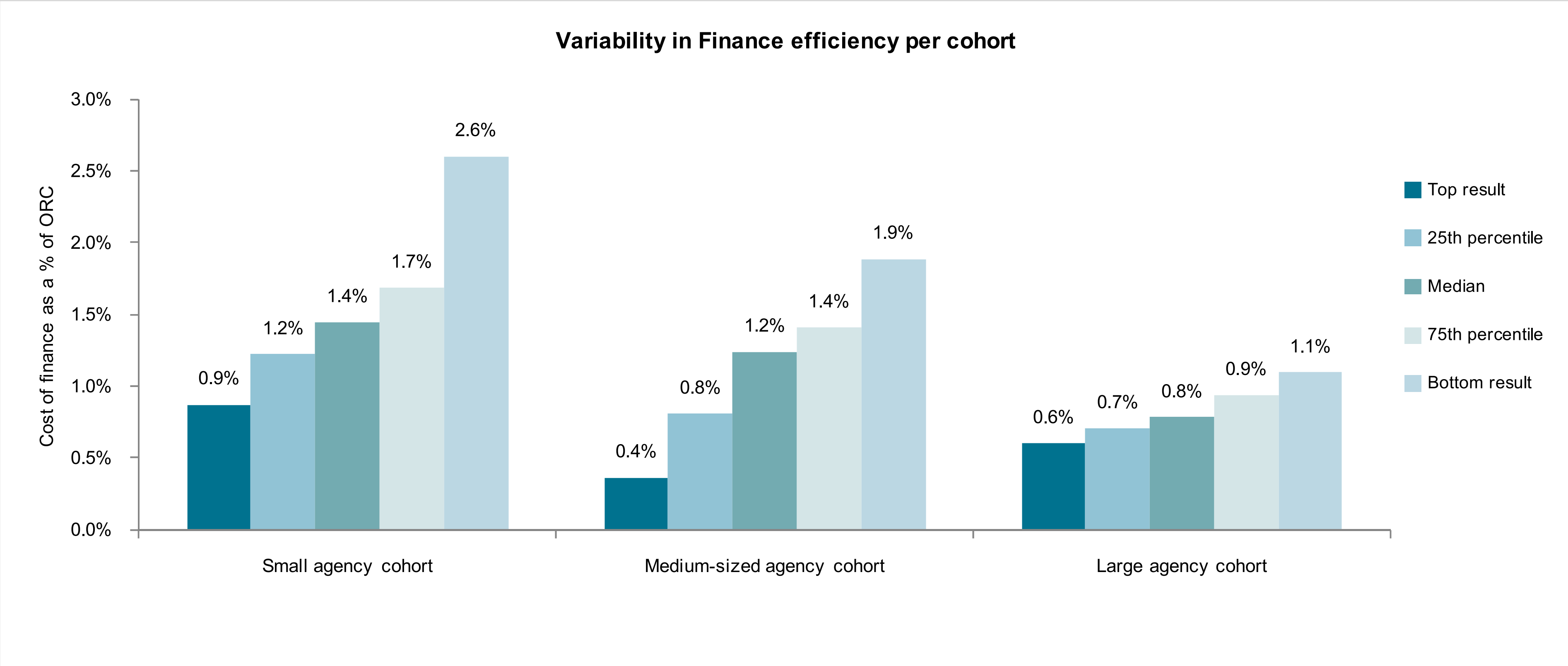
# As with previous years, the small agency cohort is less efficient than the large and medium-sized agency cohorts despite year-on-year gains



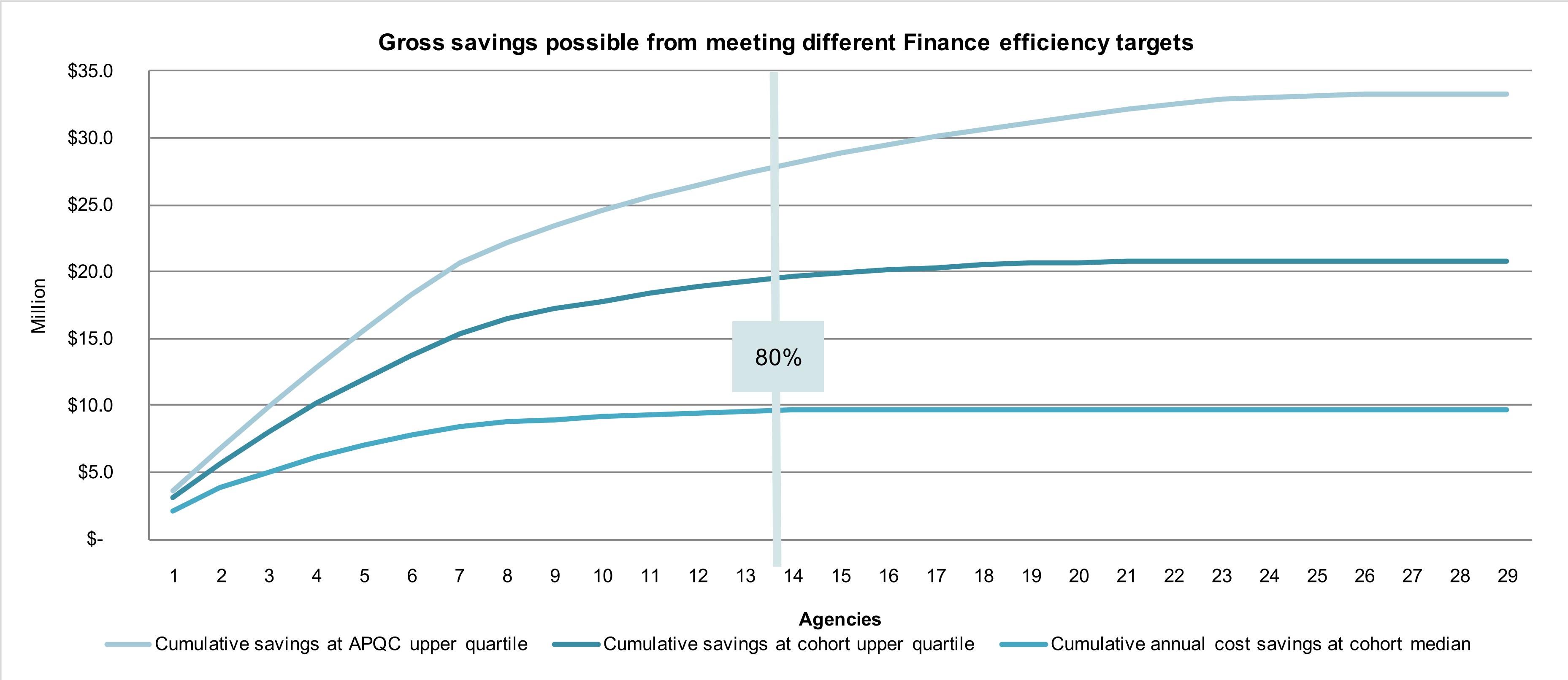

Three factors are likely to have contributed to this result:

- Fixed costs have a greater impact on smaller organisations;
- A number of small agencies may have older financial management information systems with limited automation and self-service capabilities, resulting in manual processes that are labour-intensive and inefficient; and
- Small agencies often have relatively high personnel costs as senior staff often perform a broad range of tasks, including routine administrative tasks that in large agencies would be delegated to junior staff on lower salaries.

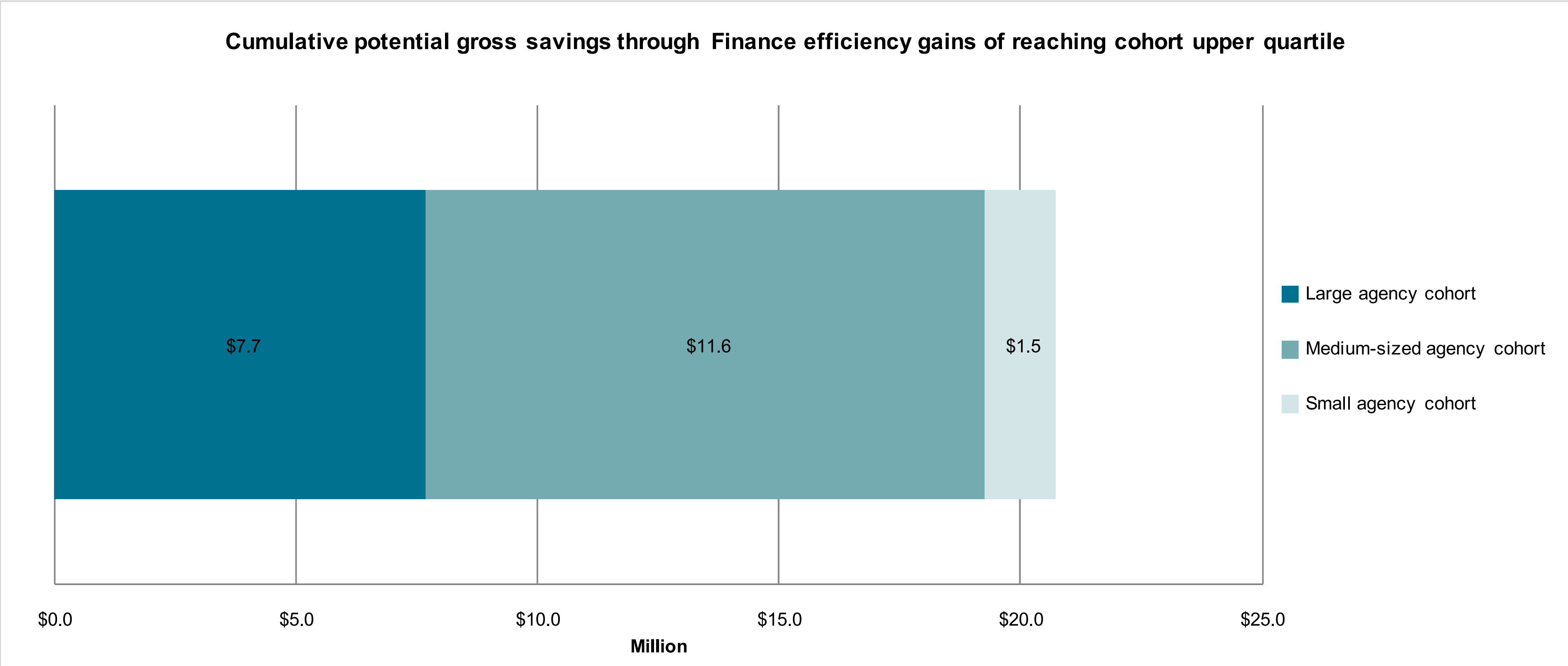
# Across all NZ cohorts, there is variability in the cost of Finance as a percentage of ORC, indicating opportunities for agencies to collaborate



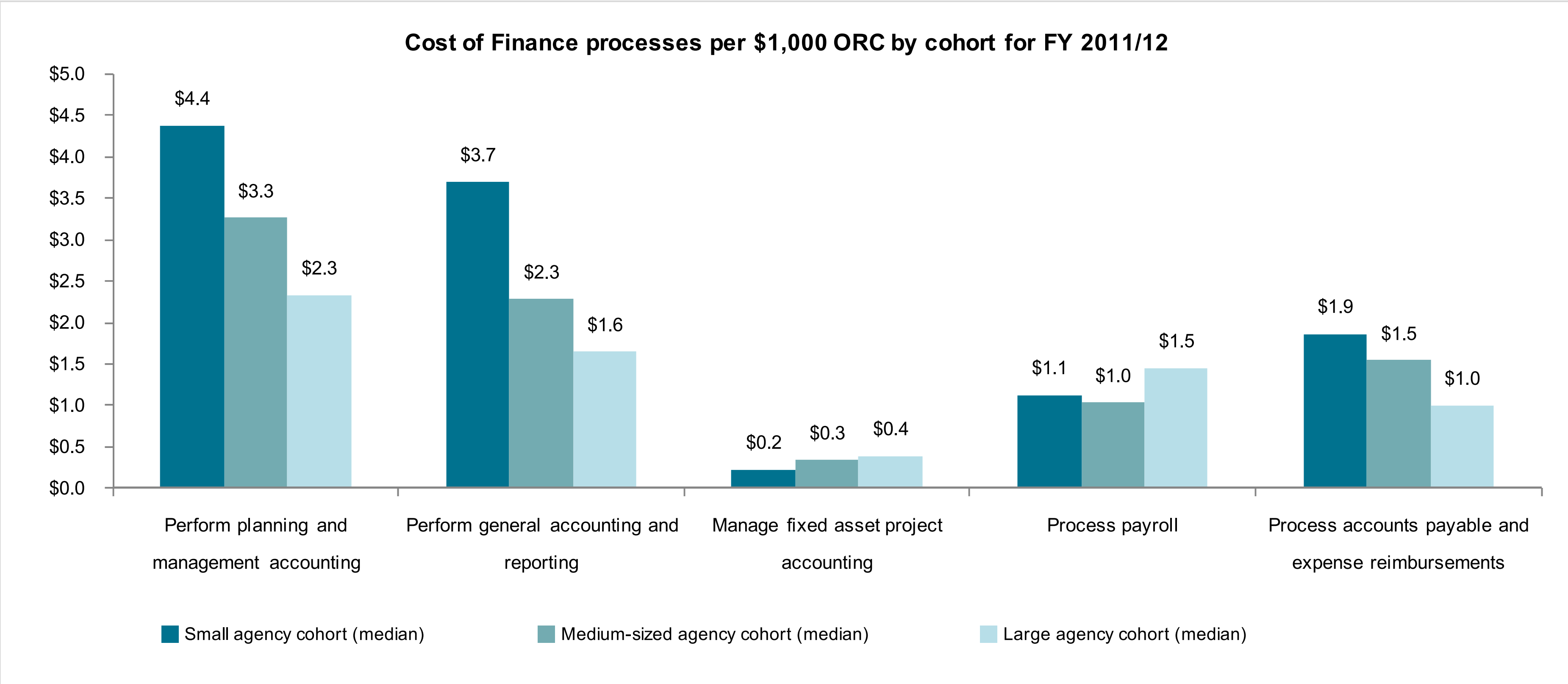
# Annual gross savings of between $9.7m and $20.7m are possible if agencies below median or upper quartile efficiency meet those levels in their cohorts



# While small agencies are the least efficient overall, the greatest potential for gross savings are in medium-sized and large agency cohorts



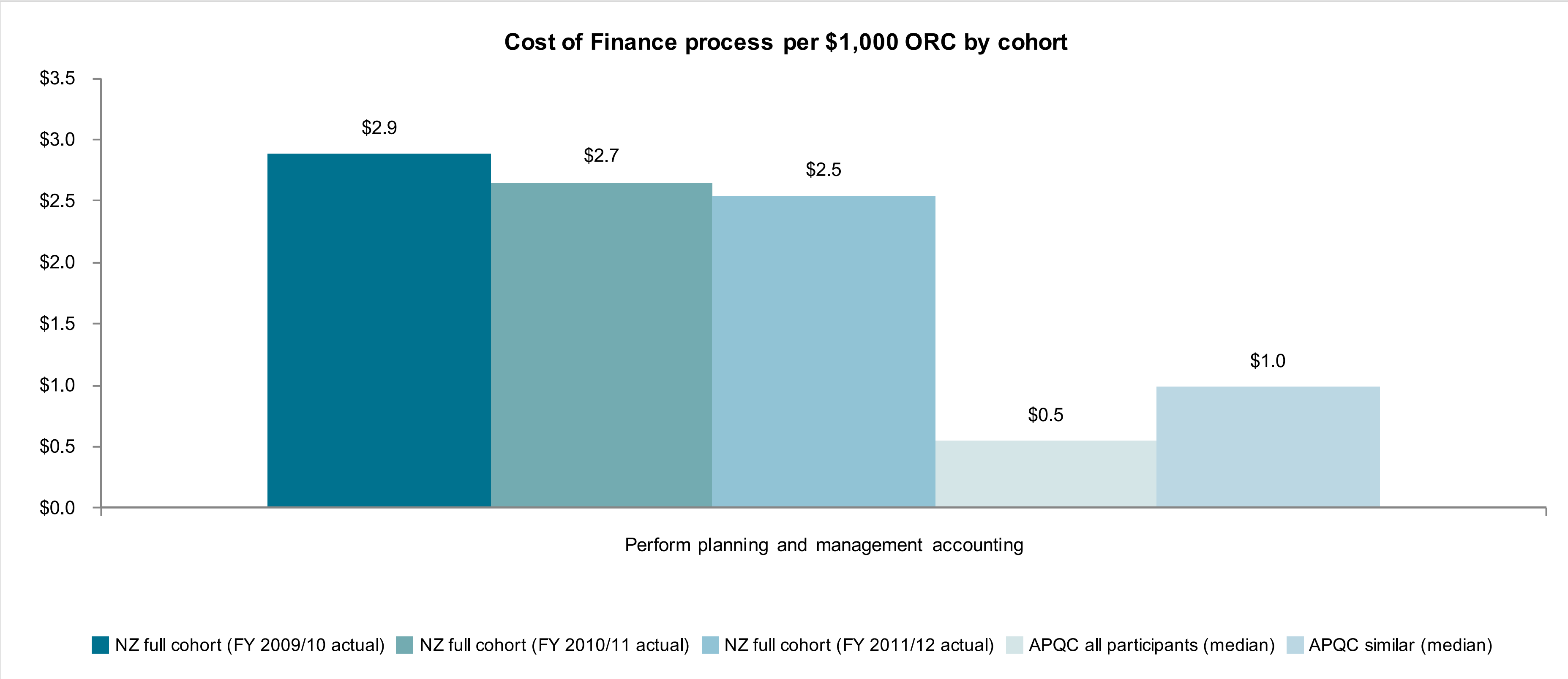
# The large agency cohort is the most efficient for most Finance processes



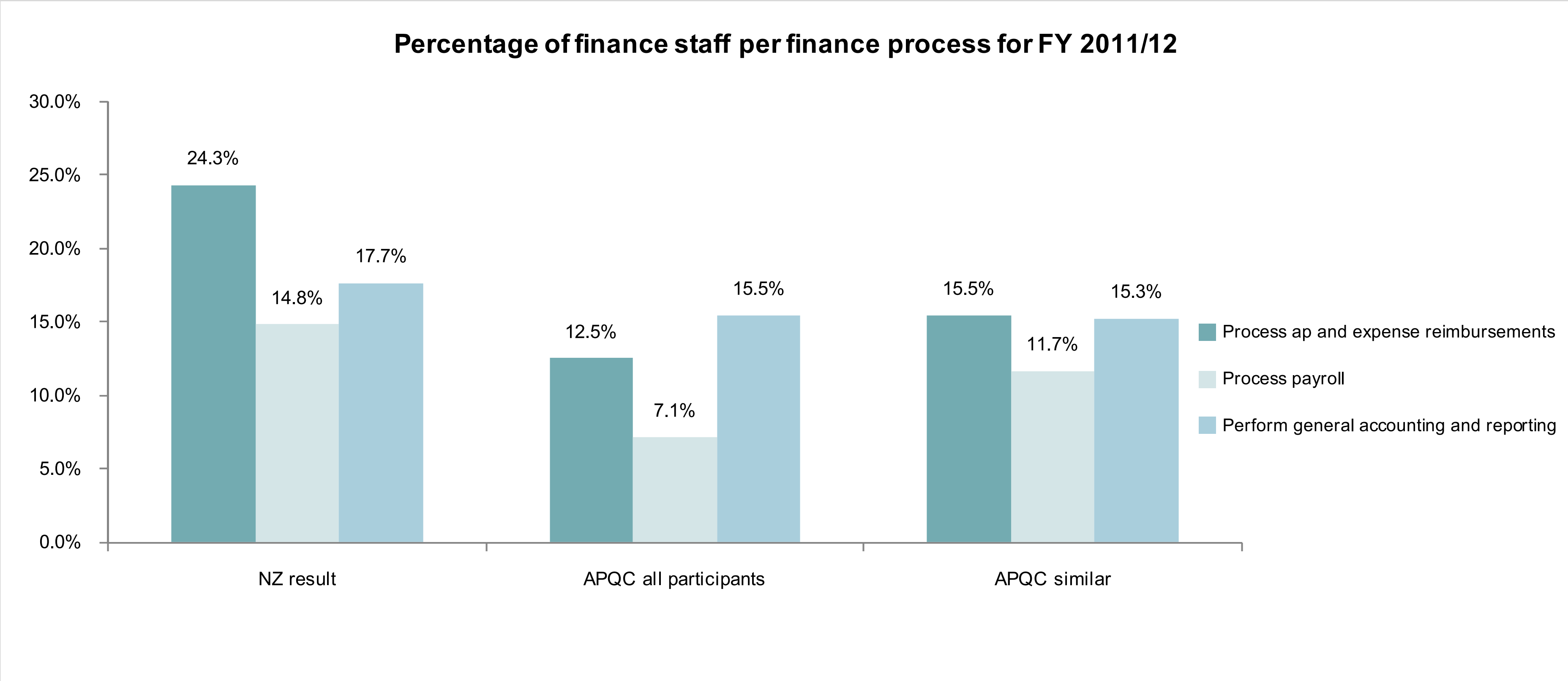

The large agency cohort is more efficient than the small and medium-sized agencies for three out of five processes. The percentage differences in process costs are as follows:

- Planning and management accounting is 91 percent higher
- General accounting and reporting is 131 percent higher
- Accounts payable and expense reimbursement is 90 percent higher

# NZ agencies reported efficiency gains in planning and management accounting, but they still lag international comparators



# NZ agencies have a greater proportion of Finance staff in transactional roles than international comparators

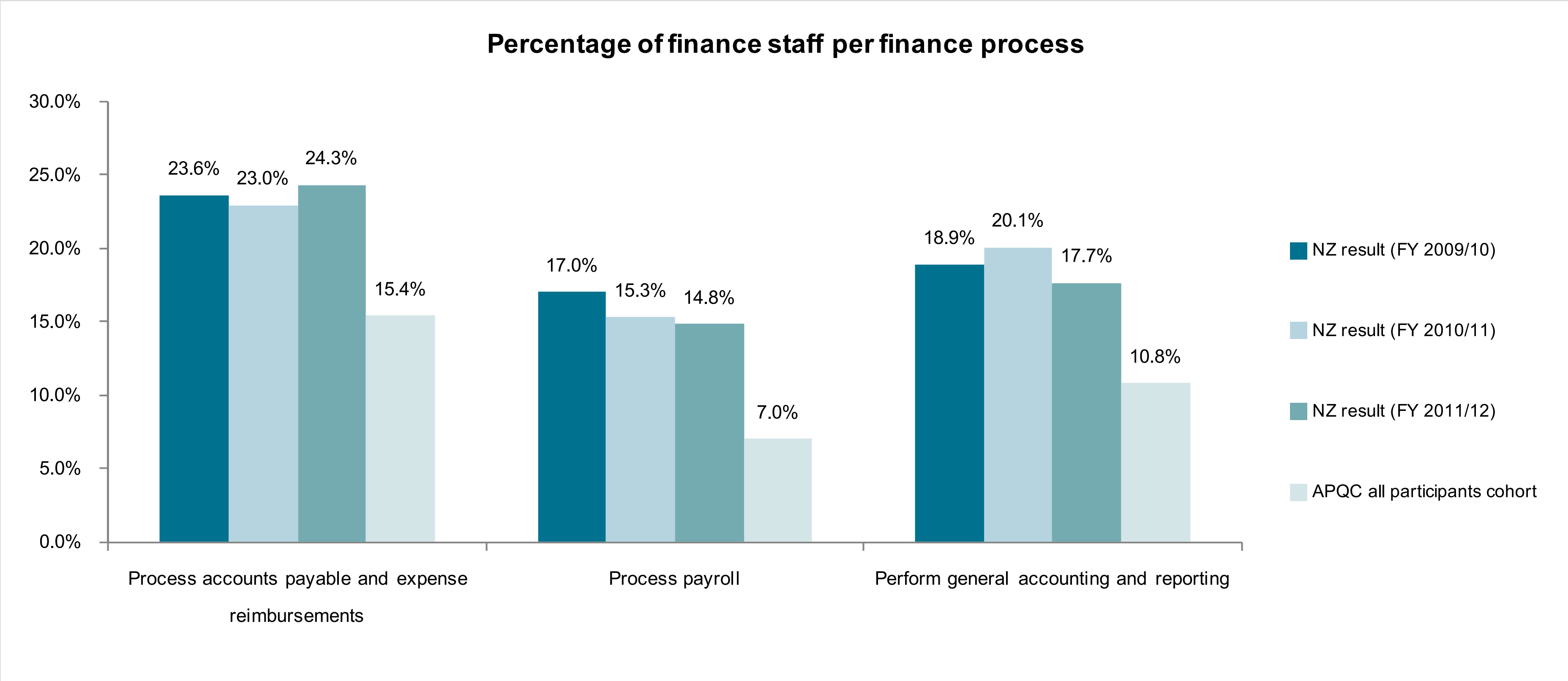



For NZ agencies, 56.8 percent of all Finance FTEs are allocated to the three processes displayed in the graph above, compared to 35.1 percent for the APQC all participants cohort. This difference shows that NZ agencies spend a disproportionate amount of effort on transaction processing.

The leveraging of scale among the finance processes of payroll, accounts payable and general accounting represents the easiest opportunity to create a more efficient finance function for the agencies

These processes lend themselves to easier and faster consolidation than can be achieved for processes such as planning and management accounting

# NZ agencies have reduced the proportion of Finance staff across transactional processes by 2.7 percent overall since FY 2009/10



# 5. EFFECTIVENESS

Effectiveness findings report on the extent to which Finance activities achieve intended or targeted results.  Improvements have been made to the effectiveness measurement for FY 2011/12, moving from the Finance MPI to the Finance Capability Maturity Model (CMM).

## The Finance Capability Maturity Model (CMM) has been introduced to improve the effectiveness measurement of the Finance function

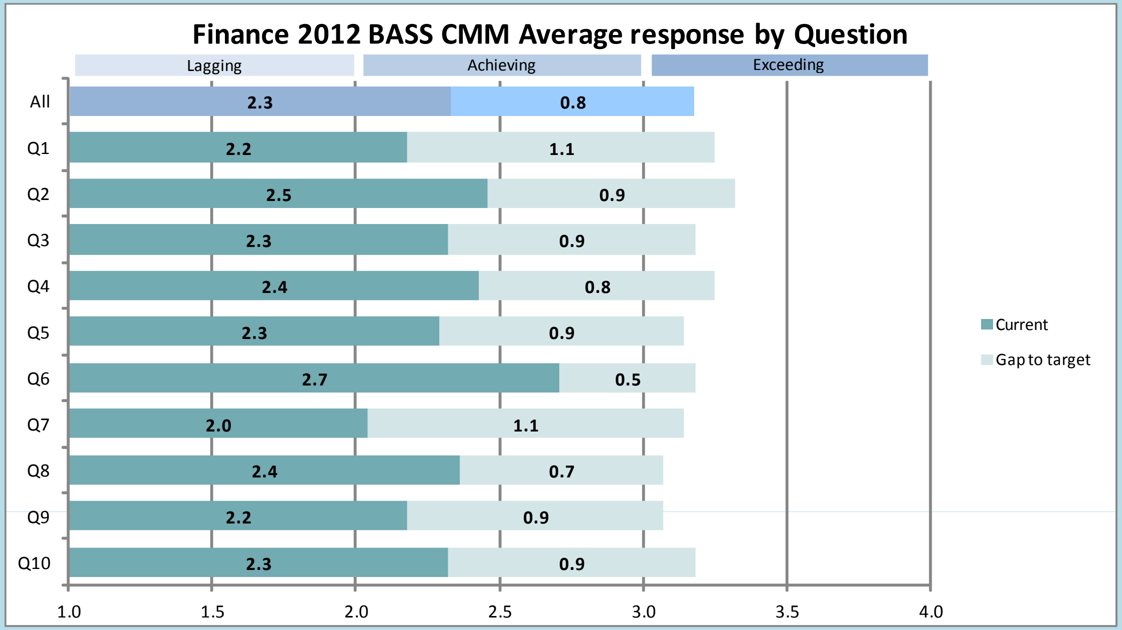
CMM moves agencies from a straight 'yes/no' assessment to a framework that enables agencies to indicate current and future assessments of their financial maturity, their priorities and any initiatives in progress.

Agencies were asked to respond to ten questions with a rating of 1-4 for both their current and aspirational state, where 1 = lagging, 2 = achieving, 3 = exceeding, 4 = leading.

The model is based on The Hackett Group’s model.

Reporting in future years will provide trend information to compare year-on-year.

# Overall, Finance management practices lag leading practices and agencies have aspirations to improve over the next two years




Q1 - Historical versus proactive forward looking reporting and analysis.

Q2 - Organisations' view of Finance's role.

Q3 - Budget process linkage to strategic or business planning process.

Q4 - Management's ease of access to relevant, timely and consistent information.

Q5 - Forecast timeliness, accuracy, and usefulness.

Q6 - Length of close and reporting cycle time, along with focus of time spent during that process.

Q7 - Extent systems are cost-effective and leverage information.

Q8 - Extent to which transaction processes are automated

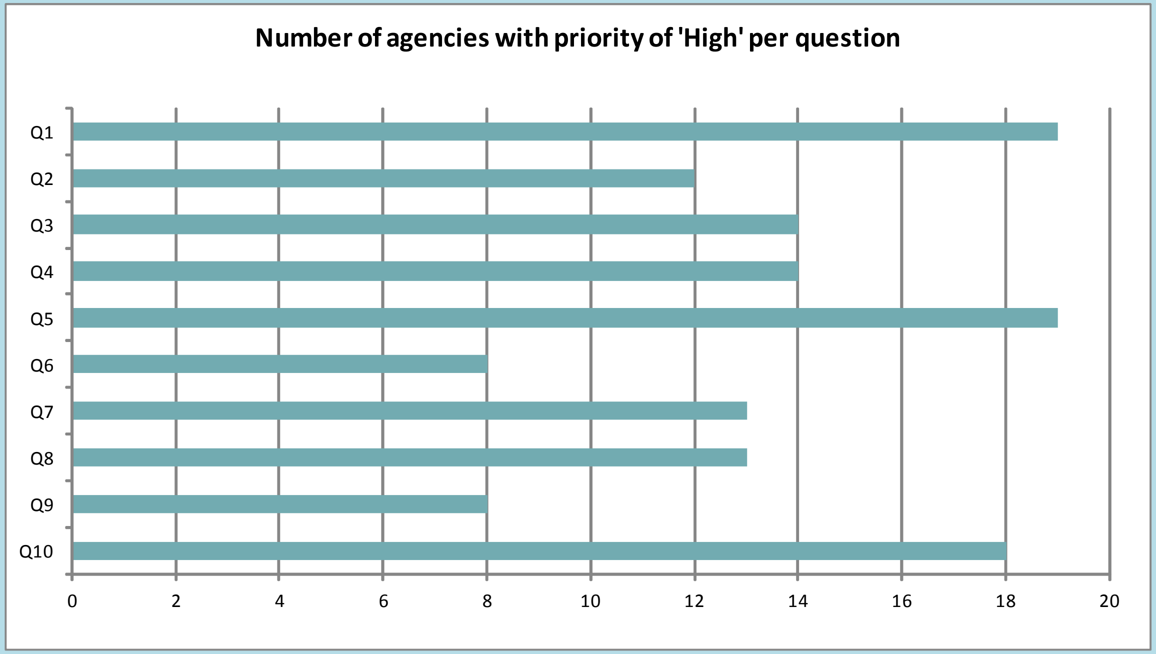
Q9 - Focus with respect to value of actions, decisions and processes.

Q10 - Extent to which finance staff have skill set and business acumen to partner with operations management.

Overall, agencies rated their most mature areas of the finance function as:

- Length of close and reporting cycle time, along with focus of time spent during that process (Q6)
- Organisations' view of Finance's role (Q2)

# Agencies may find opportunities to collaborate where peers also identify high priority areas for improvement




Q1 - Historical versus proactive forward looking reporting and analysis.
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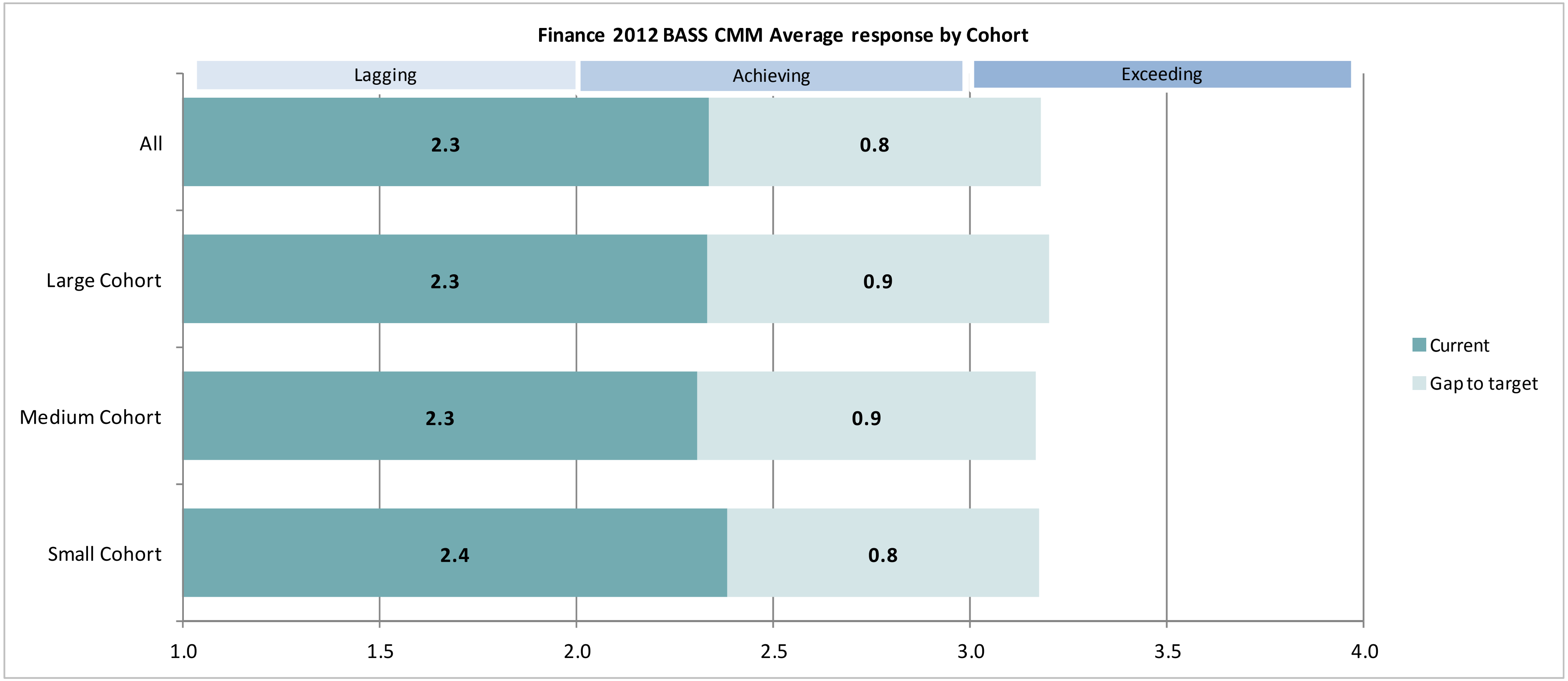
Q9 - Focus with respect to value of actions, decisions and processes.
Q10 - Extent to which finance staff have skill set and business acumen to partner with operations management.

Overall, the two highest priority areas for improvement across the NZ full cohort are:

- Historical versus proactive forward looking reporting and analysis (Q1)
- Forecast timeliness, accuracy, and usefulness (Q5)

# Agency size is not a factor for the current assessment and aspiration for maturity of the Finance function



# 6. QUALITY OF MANAGEMENT INFORMATION

These findings report on known Finance data quality issues, limitations of the indicator set in providing insight into Finance service performance, and opportunities for improvement. The introduction section in the summary BASS report includes common quality of management information findings across all functions that are not repeated in this chapter.

# Quality of Management Information

**The quality of the data underlying the metrics is of a high standard, and information can be meaningfully compared.** Finance data is collected and stored centrally by agencies, making high-quality data readily available for metric calculation.

**For this exercise, the payroll process is included within the Finance function for comparability with international benchmarks.** However, operationally, most NZ agencies consider payroll to be part of the HR function.

**Agencies have improved the consistency of reporting ORC, but there is room to improve.** Treasury will be working with agencies to help them refine measurement of ORC over FY2012/13.

**Improvements have been made to the effectiveness measures for FY 2011/12.** The Finance MPI has been amended to the Finance Management Capability Maturity Model (CMM), moving from a straight 'yes/no' assessment to a framework that enables agencies to indicate current and future levels of maturity, their priorities and any initiatives in progress. The CMM is based on The Hackett Group's model, but given this is the first year of results, quality of data may vary due to self-assessment and self reporting. No peer review was undertaken in FY 2011/12.

**The Treasury will work with agencies to look at whether peer moderation could help to improve the accuracy of reported ORC and CMM.**

## More information

A glossary of terms, definitions and source material can be accessed via the main report, available on the Treasury website: http://www.treasury.govt.nz/statesector/performance/bass/benchmarking/2011-12

A full set of BASS data can also be accessed via the Treasury website:
http://www.treasury.govt.nz/statesector/performance/bass/benchmarking/2011-12

Questions about the findings in this report should be directed to BASS@treasury.govt.nz