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Medium-term planning in government departments: Four-year plans



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Medium-term planning in government departments: Four-year plans

Presented to the House of
Representatives under section 20 of
the Public Audit Act 2001.

March 2017

ISBN 978-0-478-44258-8

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Auditor-General's overview

In recent years, the Treasury, the State Services Commission, and the Department of the Prime Minister and Cabinet (the central agencies) have been working with government departments to improve their planning. Since 2011, government departments have been required each year to produce a four-year plan that sets out their medium-term strategy. Although these plans are just one element of a department's wider planning and performance management system, they have a role in signalling the medium-term outlook of individual departments, sectors, and the Government as a whole.

For this reason, I decided to review some four-year plans to see whether they appropriately set out a department's medium-term view of where it was heading, what it would look like in the future, and how it would get there. In doing so, I recognised that the practice of preparing four-year plans is still evolving.

Several elements of departments' preparation of their four-year plans were pleasing. There were well-defined preparation processes, the roles and responsibilities of those involved were identified, senior management was strongly involved, and communication between departments and the central agencies happened when needed.

The four-year plans my staff reviewed identified each department's strategic objectives, the services the department planned to deliver during the medium term to achieve those objectives, and how the department would organise and manage its people and resources to provide those services.

However, planning is worth doing only if plans are useful and used, and I found several areas where departments could improve their four-year plans. For instance:

- Some departments were unsure about the purpose of their four-year plan and who the intended audience was. As a result, plans were often written with an unclear purpose and with a variety of stakeholders in mind, which limited their usefulness.
- Preparing four-year plans was not always fully integrated into a department's broader strategic-planning process. This is important so that a four-year plan provides a complete and consistent view of the department's medium-term strategy that aligns with other strategic plans and policies.
- I expected four-year plans to provide good information and discussion about the trade-offs a department intends to make. This did not always occur. For example, a department that identified funding shortfalls did not always consider how it would address these shortfalls. This made it difficult to understand and assess any trade-offs needed, such as changes to service levels.

- The guidance published by the Treasury and the State Services Commission makes clear that four-year plans should include financial information for all the Votes and appropriations administered by departments. However, there was little information in four-year plans on capital and asset management using this broader lens. For the departments my staff reviewed, departmental expenditure was only 21% of total Vote expenditure and departmental assets were only 29% of the total asset value of the department and the Crown entities they monitor.

Overall, our work showed that departments had variable forecasting practices that could be improved. Financial forecasting is an important component of effective medium-term planning. It allows a department to better understand its risks and uncertainties, and the steps it needs to take to mitigate these and realise opportunities.

Some departments had quite sophisticated forecasting tools. These departments could perform financial modelling and test forecasts against a range of assumptions and scenarios, with the information flowing through to the four-year plan. Other practices were less well developed, and forecasting practices were not well integrated into a department's broader planning processes.

Good forecasting relies heavily on the quality of the underlying information, the reasonableness of the assumptions used, and maintaining this information so that changes can be identified and managed. Inadequate forecasting practices can result in plans that do not provide a good basis for decision-making and accountability. This can contribute to inefficient use of resources, cost over-runs, poor service delivery, and poor resource allocation.

Experience within government departments in medium-term planning is developing. This means it is sensible for departments, with the support of the central agencies, to focus initially on preparing robust plans for departments. The Treasury has recently introduced long-term investment plans, which are expected to incorporate capital and asset management intentions. In my view, medium-term plans should better incorporate information about capital and asset management intentions and other significant matters from Votes, because of their effect on the Government's financial management and on the services to be delivered to the public.

Medium- to long-term planning is good practice in a well-developed public management system, and the introduction of four-year plans is consistent with that good practice. However, the central agencies and departments need to do more work to achieve a consistently good standard of four-year plans throughout government.

I have included suggestions about how four-year plans can be improved, which I hope will have value to departments and the central agencies so these plans can become increasingly useful and used.

A handwritten signature in black ink, consisting of a stylized 'G' followed by a horizontal line with a small curve at the end.

Greg Schollum
Deputy Controller and Auditor-General

1 March 2017

How to improve four-year planning

Departments

To continue to improve four-year plans, departments need to:

- ensure that staff responsible for preparing four-year plans have a clear understanding of their purpose and audiences so the plans support the department's and the Government's decision-making needs and strategic intentions documents support Parliament's and the public's needs;
- fully integrate the preparation of four-year plans into their strategic-planning process;
- have a well-defined process for preparing a four-year plan that provides for good senior management involvement and oversight, and regular communication with the central agencies and other stakeholders;
- ensure that the financial information contained in four-year plans is supported by the underlying financial information and is based on reasonable and supportable assumptions;
- use a robust forecasting model that allows testing of a range of scenarios and their sensitivity; and
- explain how they will achieve their objectives and strategic intentions, and any trade-offs and prioritisation.

The central agencies

To continue to improve four-year plans, the central agencies need to:

- consider the relationship, purpose, and contents of four-year plans and strategic intentions documents to ensure that useful and good quality medium-term information is available for departmental, central agency, and governmental decision-making while serving the needs of Parliament and the public;
- continue to improve their guidance about preparing four-year plans, including guidance on standard and common financial assumptions, and how the plans are used in the context of the Government's overall financial management system; and
- work to improve medium-term planning by requiring departments to include information about medium-term planning matters, such as about capital and asset management intentions, for all Votes and appropriations the departments administer.

Introduction

- 1.1 Since 2011, Cabinet has required each government department to prepare a plan each year that provides a medium-term perspective of the department's intentions.¹
- 1.2 We have done extensive work auditing the long-term plans of local authorities since they were first required to be audited in 2006. We consider that our work has contributed to improvements in local authorities' long-term planning. For example, we have seen improvements in the quality of forecasting and the underlying information and assumptions used.
- 1.3 We know that medium- to long-term planning is most important and relevant for entities responsible for assets and resources with long lives that affect the delivery of public services.
- 1.4 Given the importance of four-year plans to government departments and the Government's annual Budget process, we decided to draw on our local authority experience to review a selection of four-year plans.
- 1.5 As a tool for providing a medium-term perspective of a department, four-year plans are still evolving. Accordingly, the aim of our work was to review a small sample of four-year plans and identify where they could be improved and strengthened.
- 1.6 Forecasting is an essential component of good financial management, decision-making, and planning. It is important that the forecasts in four-year plans are based on information and assumptions that are reasonable and supportable.
- 1.7 Although generally accepted accounting practice (GAAP)² does not directly apply to four-year plans, the principles are relevant and appropriate. GAAP requires an entity to use the best information available to prepare the prospective financial statements. It requires that prospective financial statements be understandable, relevant, reliable, and comparable and that the assumptions used in the prospective financial statements be reasonable and supportable.
- 1.8 Four-year plans that are prepared according to GAAP principles should provide good information about where a department is spending its money and how its resourcing might shift over time.

1 In 2012, four-year budget plans were combined with a department's workforce strategy to become the department's four-year plan.

2 Generally accepted accounting practice is a common set of accounting principles, standards, and procedures that organisations use to compile their financial statements, including prospective financial information.

International context

- 1.9 New Zealand is not the only country to consider how to improve its medium- to longer-term strategic and financial planning. The United Kingdom and Australian national audit offices have identified strategic challenges to effective medium- to longer-term planning.
- 1.10 For example, in 2013 and 2014, the National Audit Office in the United Kingdom carried out work on forecasting in government. This work found that:
- departments do not always make best use of forecasting (for example, to test potential options and scenarios);
 - decision-makers do not always understand the implications of forecasts or know how to use them to challenge and manage risks; and
 - there are often weak relationships between areas of technical expertise (asset managers and planners) and finance staff, increasing the risk of poorly informed budget decisions.
- 1.11 We took international developments and findings into account when planning and doing our audit work.

How we carried out our work

- 1.12 Our focus was on the financial information contained in each plan. We selected departments that had Vote responsibility for significant public sector assets or resources that interact with local government's planning and management responsibilities. On this basis, we selected:
- the Ministry of Transport;
 - the Ministry for the Environment;
 - Land Information New Zealand; and
 - the Ministry of Business, Innovation and Employment.
- 1.13 Although we looked at only a small sample of four-year plans, we consider that they were representative enough to allow us to make suggestions for improvement that other departments preparing four-year plans could apply.
- 1.14 For each department, our work involved:
- understanding how the department prepared its four-year plan;
 - understanding the context for the four-year plan – for example, how the department had incorporated its other plans and policies into the four-year plan;

- evaluating the completeness of information about the activities of Crown entities in the Votes administered by the department;
- assessing whether the financial forecasts were based on the best information available and whether the assumptions applied in the four-year plans were reasonable and supportable;
- determining whether four-year plans provided a detailed analysis of the effect of any costs pressures or savings on the services the department delivers; and
- assessing the extent to which the department was using its four-year plan to support sound decision-making and to manage risks.

1.15 To complete the reviews, we:

- interviewed strategy, performance, and finance staff and also members of management to understand the processes and assumptions underpinning four-year plans;
- reviewed whether the four-year plans aligned with the guidance produced each year by the Treasury and the State Services Commission (the published guidance);³
- reviewed whether the four-year plans were consistent with a department's accountability documents;
- reviewed supporting documentation for selected amounts included in forecasts; and
- reviewed the main documents that departments used to prepare their four-year plans.

1.16 The four-year plans we reviewed were those prepared for Budget 2015, and our work used the published guidance for that year as its starting point. The published guidance has since been updated, for Budget 2016 and Budget 2017, so we have noted where we have used the updated guidance.

1.17 Our findings and recommendations are based on the 2015 four-year plans prepared by the departments we selected. Some of the four departments have already started to implement the changes that we have recommended.

What we did not do

1.18 We did not:

- review how four-year plans aligned with the Government's Business Growth Agenda and Better Public Services priorities;
- reconcile the numbers in the four-year plans to specific Votes;

³ The people who act as functional leaders on property, procurement, and information communications technology – see www.ssc.govt.nz/bps-functional-leadership – are also involved in producing the guidance about four-year plans and working with departments as they prepare four-year plans.

- analyse the cost of budget initiatives; or
- assess the degree of alignment between a department's strategic direction and its non-financial capabilities.

Structure of this report

- 1.19 Part 2 describes the requirements for a four-year plan and how the plan fits into a department's broader strategic-planning process.
- 1.20 Part 3 looks at how departments prepare their four-year plans and concludes with our suggestions for improving their preparation.
- 1.21 Part 4 looks at whether four-year plans are based on the best available information and how departments integrate that information to plan services and address any cost pressures. Part 4 also concludes with suggestions for improvements.

Four-year plans and the strategic-planning process

2.1 Four-year plans are designed to form part of a government department's broader strategic-planning process.

2.2 In this Part, we set out:

- what four-year plans are expected to include;
- how a department's four-year plan fits into its broader strategic-planning process; and
- how a department's four-year plan relates to its strategic intentions.

What four-year plans are expected to include

2.3 In 2011, four-year budget plans were focused on financial matters – for example, providing the Government with relevant financial information to prepare its annual Budget. In 2012, these were combined with a department's workforce strategy requirements to become the department's four-year plan.

2.4 Four-year plans have evolved since they were first introduced. They are now considered to be a department's primary medium-term planning document. Their main purpose is to provide a medium-term perspective of a department in the context of its longer-term vision, the outcomes it seeks, its strategic intentions, and how it will contribute to and achieve these.⁴

2.5 A four-year plan is expected to reflect the department's strategic objectives and intentions, who its customers are, the interventions the department plans to make to achieve its strategic objectives and intentions, and how the department will organise and manage its people and other resources to achieve those objectives and intentions.

2.6 The Treasury and the State Services Commission publish guidance each year on the matters that a four-year plan should contain. The plans should include:⁵

- *financial information* – this should tell the department's four-year financial story in the most meaningful way for the department and should also include commentary on departmental and significant non-departmental expenditure;
- *strategic objectives and delivery* – this should describe the department's strategic objectives and who its customers are;
- *strategic choices and trade-offs* – this should discuss the strategic choices and trade-offs facing the department and when these choices need to be made;
- *workforce strategy* – this should include discussion about how the department will position its workforce to meet its strategic objectives and include its workforce capacity, capability, and current and expected workforce costs;

4 See the 2016 edition of the published guidance – *2017 Four Year Plan Guide*, available on the State Services Commission's website (www.ssc.govt.nz).

5 See the 2016 edition of the published guidance.

- *asset management and investment intentions* – this should discuss the existing state and performance of the department’s asset base, the factors that are expected to affect the future use of assets the department manages, and how a department will manage its capital needs during the four-year period; and
- *Crown entities the department monitors* – the department should outline the way in which Crown entities contribute to the department’s strategic objectives and/or wider government objectives, how the department intends to manage its relationship with Crown entities, and the sustainability of Crown entities.

How four-year plans fit into a department’s broader strategic-planning process

- 2.7 The purpose of four-year plans is to provide a medium-term perspective of departments in the context of their longer-term vision, the sector they work with or are responsible for, and set out how they will get there. The primary user of a four-year plan is the department itself – the plan will provide insight into what the department’s strategic objectives are, the interventions the department plans to use in the next four years to achieve its strategic objectives, and how the department will organise and manage its people and other resources to achieve its objectives.
- 2.8 It is also intended that Ministers of the Crown will use four-year plans to:
- confirm that departments are clear about their strategy;
 - understand how departments are planning to use their baseline funding to achieve their strategy and the Government’s priorities; and
 - understand the priorities, performance, pressures (including cost pressures), and risks of departments.
- 2.9 The Treasury and the State Services Commission might use four-year plans to:
- get insights into the quality of thinking and decision-making in a department’s medium-term planning process;
 - understand what departments will do individually and collectively to achieve the Government’s priorities and objectives; and
 - inform advice to Ministers at a departmental and whole-of-government level on strategic issues and choices, operational and capital sustainability, trade-offs, and priorities.⁶

How departments' four-year plans relate to their strategic intentions

- 2.10 A four-year plan is one of two medium-term planning documents that government departments are required to prepare and one element of a department's overall planning, management, and reporting activity.
- 2.11 The other medium-term planning document is the strategic intentions. The Public Finance Act 1989 requires a department to provide its Minister with, and subsequently make public, information on its "strategic intentions" for the forthcoming year and following three years. Strategic intentions (usually set out in a Statement of Intent) set out the strategic objectives that the department intends to achieve or contribute to and should also:
- provide a medium- to long-term perspective of the department;
 - explain the nature and scope of the department's functions and intended operations;
 - explain how the department intends to manage its functions and operations to meet its strategic intentions;
 - set out the department's contribution to the Government's outcomes and specific priorities, reflecting the discussions between the department and its Minister(s) about priorities and desired results; and
 - be published on the department's website and presented by the responsible Minister to the House of Representatives.
- 2.12 Other documents that can form part of a government department's overall planning, management, and reporting activity include:
- *A department's annual plan.* A department's annual plan provides a detailed plan of its short-term activities and intentions, and how these will contribute to the department achieving its strategic objectives.
 - *Long-term investment plans.* Changes to the investment-management system came into force on 1 July 2015. These changes require "investment-intensive" departments to prepare investment plans that have a minimum 10-year planning horizon. The focus of these plans is on capital expenditure and asset performance and disposal. The plan should set out the department's investment plan based on its current long-term vision and objectives, what it will invest in, and how investment will occur to support delivery of the department's or sector's long-term goals.⁷
 - *A department's internal strategies and plans.* A department will have internal strategies and plans that will inform the preparation of its four-year plan. For example, this will include its workforce, information technology, and financial and asset management plans.

⁷ See page 10 of the 2016 edition of the published guidance.

2.13 Figure 1 sets out how four-year plans interact with a department's other planning documents.

Figure 1
Relationships between different strategic planning outputs



Source: Adapted from the Treasury (2016), *Guidance for Developing and Maintaining a Long Term Investment Plan*, page 22.

Preparing four-year plans

3.1 In this Part, we discuss:

- the need for a good understanding of the purposes and audiences of four-year plans and strategic intentions documents;
- whether four-year plans provide an integrated view of a department's strategy and have robust links with existing plans; and
- the need to have a well-defined process for preparing a four-year plan, which provides for good senior management involvement and oversight, and regular communication with the central agencies and other stakeholders.

Summary of our findings

3.2 Some departments were unsure about the purpose of their four-year plans. This resulted in them writing the plan for a variety of stakeholders, which limited its usefulness.

3.3 To ensure that a department's four-year plan provides a consistent view of its medium-term strategy, the department should fully integrate its preparation of its four-year plan into its existing strategic-planning process. Departments generally had a plan for preparing their four-year plans, but these were not always fully integrated into the department's broader planning processes.

3.4 Departments had good engagement with the central agencies when preparing their plans.

3.5 Departments recognised the importance of four-year plans and ensured that chief executives, other senior managers, and, where appropriate, audit committees were involved in preparing and reviewing the plans.

A good understanding of the purposes and audiences of four-year plans and strategic intentions documents

3.6 A department's four-year plan and its strategic intentions document are designed to complement each other:

- A department's strategic intentions document is high-level information that informs Parliament and the public about the department's strategic objectives and how these relate to the Government's broader strategies and priorities, focusing on the department's intended achievements and contributions.
- A department's four-year plan is focused on a department's medium-term strategy and, in particular, how the department will implement its strategy and achieve its objectives and strategic intentions. Since 2015, the published guidance has clarified that the primary users and audience of a four-year plan are the department, Ministers of the Crown, and the central agencies.

- 3.7 We expect a department's four-year plan and its strategic intentions to result from the department's strategic-planning process. The four-year plan and strategic intentions document both have a medium-term focus. For example, a four-year plan has a minimum horizon of four years. A department's strategic intentions document relates to the forthcoming financial year and at least the following three years.
- 3.8 Although the four-year plan and strategic intentions document both have a medium-term focus, they have different audiences, purposes, and publishing requirements that departments need to understand, consider, and plan for.
- 3.9 Four-year plans need to be based on good quality and useful information about the medium term to support the decision-making of each department and of the Government. Good quality, useful information about the medium-term directions of the Government's finances, assets, and services is also needed to support Parliamentary decision-making and for public accountability.
- 3.10 A department can, but is not required to, publish its four-year plan. Four-year plans include detailed and potentially sensitive information about funding, staffing, and the trade-offs the department is intending to make to meet its objectives and achieve its strategy.
- 3.11 We found that some departments were unsure about the purpose of the plan and who the intended audience was. There was also uncertainty about what departments should include in plans, because some departments were uncertain about whether the plans would be made public and, consequently, whether the department should include budget-sensitive information in them.
- 3.12 This resulted in a range of issues that included departments:
- excluding detailed strategies from four-year plans;
 - excluding service delivery trade-offs that were needed for a department to avoid overspending; and
 - comprehensively reworking a four-year plan to exclude sensitive information before it could be made public
- 3.13 For some four-year plans we reviewed, uncertainty about the audience and purpose of the plans created costs in time and effort, and limited the usefulness of the plans.
- 3.14 One department believed that the problem was not so much that it was unsure or confused by the intended audience. Rather, it found difficulty in writing a document to meet the needs of different audiences.

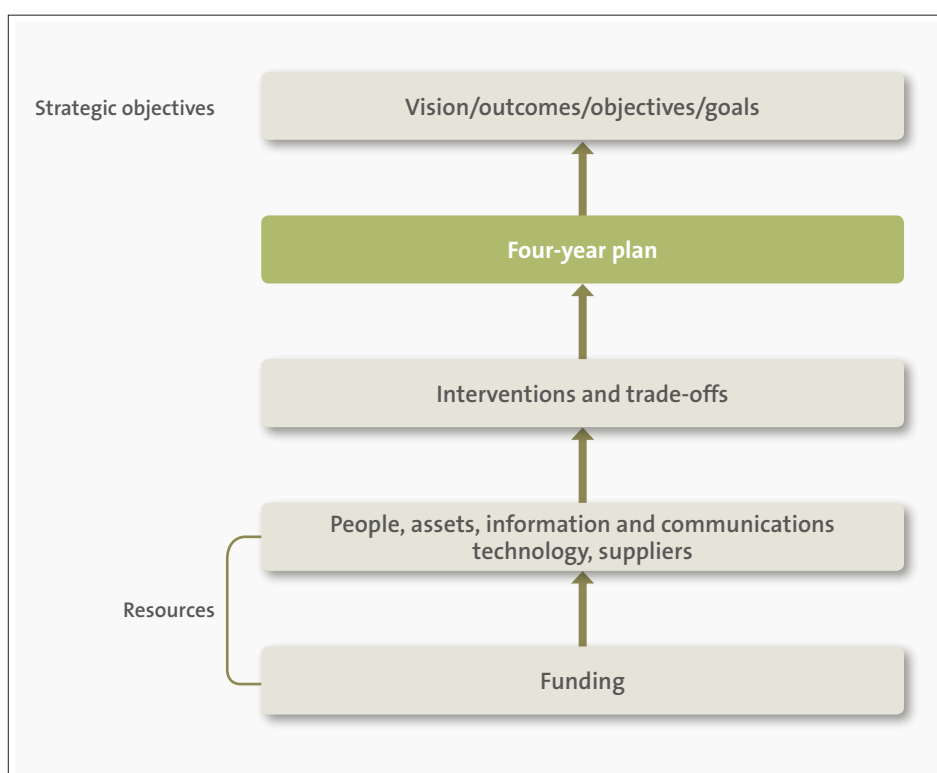
Integrated view of a department's strategy and robust links with existing plans

- 3.15 A four-year plan should also be aligned and integrated with other departmental strategic-planning documents, providing a complete and integrated view of the Votes administered by the department for all years covered by the plan. We also expect to see strong and clear links between the four-year plan and the department's existing plans, policies, and annual reports.
- 3.16 We saw good examples of four-year plans that had been prepared with a clear strategic direction and that provided enough information to inform the reader of the department's goals and objectives for the next four years.
- 3.17 These examples of four-year plans made it clear what the department's objectives were during the next four years and provided a consistent story that aligned with the department's longer-term vision, strategic intentions, and annual report.
- 3.18 One department provided a list of legislative and strategic priorities. It then used these to inform its four-year plan. Other departments aligned the main themes and objectives in their four-year plans with other documents they published, such as the Statement of Intent (now strategic intentions), the Performance Investment Framework four-year excellence horizon, and the annual report. All these documents included the same issues and objectives for the same four-year period.
- 3.19 However, departments could provide better information and a more integrated view of how they will contribute to their objectives and strategic intentions, how they will achieve these, and the challenges they will face. For example, some plans:
- were too high-level, with information mainly about the department's vision rather than specific issues the department will face in the next four years;
 - contained too much information about the department's current operations, rather than what the department would do to change in the face of challenges to its operations in the next four years;
 - lacked information or discussion about how the department's strategic vision and goals linked with its current business-as-usual operating model;
 - lacked information on the relationship between the levels of service provided and the funding needed to achieve these targets; and
 - lacked information about how the department's goals would be achieved. For example, the department might know what it would like to achieve but did not state how it would do that or the resources it would need.

A well-defined process for preparing a four-year plan

- 3.20 To produce a four-year plan that is effective, credible, and coherent, a department needs to have a robust four-year plan preparation process. We expected departments to have a well-defined process for preparing a four-year plan.
- 3.21 Figure 2 shows the factors a department should consider when preparing its four-year plan. Essentially, a four-year plan can be viewed as the “integrator” of a department’s long-term goals and objectives with the resources available to achieve these long-term goals. Its job is to explain what a department will be doing, what resources it will use, how much the activities will cost, and what the results are expected to be.

Figure 2
Four-year plan preparation process



- 3.22 We saw good examples of departments planning to prepare their four-year plan. In particular, we saw examples of departments preparing timetables and other documents at the beginning of the process that were clear and provided relevant information explaining the milestones needed to meet the Treasury's and internal deadlines. Also, one department split timelines between initial engagement and information gathering, drafting and consultation, and finalisation and delivery, which, in our view, was good practice.
- 3.23 Although departments generally planned for the preparation of their four-year plan, their preparation did not always go as intended and they did not always consider practical matters.
- 3.24 We saw one example of staffing changes adversely affecting a four-year plan. Several staff involved at the end of the process had little involvement in the earlier planning and decisions, so it was unclear who was responsible and accountable when specific concerns arose later.
- 3.25 These difficulties could have been avoided if the department had hand-over protocols to maintain overall ownership of the process during staff changes.
- 3.26 Preparation of a four-year plan was not always integrated into the department's planning process. This increased the risk of no strong engagement in the department about the plans. It also increased the risk that the plan was inconsistent with other plans and accountability documents.
- 3.27 For example, one department established discrete, stand-alone work streams to prepare individual reports that could then be used in the four-year plan. However, these discrete pieces of work did not deliver the appropriate information, meaning further work had to be done. In another situation, the lack of integration into planning processes meant that the four-year plan contained outdated information.

Involvement and oversight from senior management

- 3.28 Because the four-year plan is a crucial medium-term strategic document, it is important that senior management are involved in the preparation and oversight of the four-year plan.
- 3.29 In the departments we looked at, senior management staff, including chief executives, were involved in preparing the plan. The nature of the involvement was good and varied. For example:
- One department set up a governance group of senior managers to oversee the preparation and completion of its four-year plan. The group met regularly to discuss progress and any issues arising with the preparation of the four-year plan. The governance group appeared to work well.

- One department allocated responsibility for the plan's preparation to the deputy chief executive, who reported on progress to the senior leadership team.
- One department allocated responsibility for preparing its four-year plan to its planning and performance team, with the department's senior leadership team reviewing the four-year plan.

- 3.30 Two departments provided drafts of their four-year plans to their audit committees for review.
- 3.31 Overall, senior management were strongly involved in preparing the four-year plans, which is encouraging.
- 3.32 Departments also discussed their draft plans with their Ministers, which, for at least one department, led to a successful budget bid.

Regular communication with the central agencies

- 3.33 Departments have been preparing medium-term plans since 2011, and the preparation process has been evolving to take account of changes to the plans' audience and purpose. Departments have updated their approach to preparing plans accordingly.
- 3.34 To help departments prepare four-year plans, the Treasury and the State Services Commission publish annual guidance. The published guidance includes information about what a four-year plan is, the process for its preparation, the main changes from the previous year's requirements, and what the department's four-year plan should include.
- 3.35 The published guidance previously included a series of Annexes covering workforce capability, financial information, asset management, key assumptions, and anticipated funding requests that departments are required to complete. The published guidance is updated annually to reflect changes from the previous year and include any lessons learnt from previous planning rounds. The 2017 guidance now requires only one (financial) annex, along with key information to be provided in the body of the four-year plan.
- 3.36 Departments had good engagement with the central agencies when preparing their plans. However, at least one department found the published guidance difficult to follow. This department had face-to-face meetings with the Treasury to establish what the requirements were. Another department consulted with the Treasury throughout the four-year plan preparation process.

- 3.37 In our view, experience in government departments and the central agencies in medium-term planning has been developing. The Treasury and the State Services Commission continue to improve their four-year planning guidance in response to feedback from government departments and their own observations about how plans are developing. We encourage the Treasury and the State Services Commission to continue this improvement work.

How to improve four-year planning

- 3.38 To continue to improve four-year plans, departments need to:
- ensure that staff responsible for preparing four-year plans have a clear understanding of their purpose and audiences so the plans support the department's and the Government's decision-making needs and strategic intentions documents support Parliament's and the public's needs;
 - fully integrate the preparation of four-year plans into their strategic-planning process; and
 - have a well-defined process for preparing a four-year plan that provides for good senior management involvement and oversight, and regular communication with the central agencies and other stakeholders.
- 3.39 To continue to improve four-year plans, the central agencies need to consider the relationship, purpose, and contents of four-year plans and strategic intentions documents to ensure that useful and good quality medium-term information is available for departmental, central agency, and governmental decision-making while serving the needs of Parliament and the public.

4

Integrating best information and reasonable assumptions

- 4.1 In this Part, we look at the information provided in four-year plans, including:
- the scope of four-year plans;
 - forecasting assumptions;
 - financial forecasting;
 - integration of financial information into a department's operational activities, and analysis of choices and trade-offs; and
 - asset management and capital intentions.

Summary of our findings

- 4.2 Assumptions are fundamental to forecasting in general and to the usefulness of four-year plans. Although some plans stated the assumptions used, the assumptions were inconsistently identified, applied, and calculated and did not always provide enough information to understand the funding needed to achieve a department's objectives.
- 4.3 It is important that four-year plans are based on the best and most complete information available for all the Votes and appropriations administered by the department. Four-year plans currently focus primarily on the department's operations, rather than all the Votes and appropriations administered by the department.
- 4.4 Departments should have a good understanding of where their funding is spent, why it is spent, and how resourcing will shift to priority areas during the four years. They should have budget forecasting models for estimating future costs, service demands, resources needed to deliver services, and revenue requirements. One of the four departments we looked at had an excellent flexible budget forecasting model, but others lacked a robust forecasting system or had a system that was not well integrated throughout the department.
- 4.5 Information contained in four-year plans made it difficult to assess the trade-offs and prioritisation that would be needed to ensure that a department did not overspend. Departments identified cost pressures and funding shortfalls but did not always provide detailed information about how the shortfalls in funding would be addressed or the actions the department would take to address cost pressures.
- 4.6 Information in four-year plans on assets was generally less well developed, meaning that the plans are not yet likely to effectively identify cost pressures and risks, and the effect of these on the finances of the Government and the services intended to be delivered to the public.

- 4.7 Recent capital and asset management initiatives taken by the Treasury should strengthen four-year planning, allowing departments to better incorporate information about sector trends, and capital and asset management intentions.

Scope of four-year plans

- 4.8 The published guidance provides advice on the scope of four-year plans and the matters that should be addressed, according to their significance.
- 4.9 Departments are requested to include in their four-year plans information about:
- all of the Votes and appropriations they administer;
 - the state of the sector/department's asset base and the performance of, and any issues for, the sector in managing capital assets and areas for improvement;
 - the Crown entities that the department monitors, including the sustainability of the Crown entity and its contribution to the department's strategic objectives; and
 - any sector and functional leadership roles of the department, including its contribution to the Government's priorities and cross-department objectives.

Forecasting assumptions

- 4.10 The published guidance does not specify the assumptions that a department should use when preparing its four-year plan. Each department is considered to be best placed to determine those assumptions. We agree that a department's assumptions should reflect the department's circumstances.
- 4.11 However, we found that assumptions used in four-year plans were limited. In our view, they did not necessarily provide enough information to understand the funding needed to achieve a department's objectives.
- 4.12 We identified several issues with the way departments used and applied assumptions, including:
- Assumptions were usually about financial matters. Assumptions about other matters, such as government policy, demographics, and expected demand for services, were not always disclosed, included, or consistent with other plans or strategies.
 - Two of the four departments we reviewed did not allow for inflation during the period of the plan.
 - The description of actual assumptions used for forecasting was sometimes incomplete, meaning that it was difficult to understand the assumptions used.

- Inconsistent assumptions were used in the four-year plan.
- There was not enough available evidence to support or justify some assumptions.

Financial forecasting

- 4.13 The financial starting point for four-year plans are the baselines for Votes as at the relevant October Baselines Update. All financial information referenced in a four-year plan must be “anchored” to this starting point.⁸
- 4.14 In terms of the Government’s budgeting cycle, this timing allows the Treasury to review individual four-year plans and for the plans to inform budget decisions made by the Executive branch of government. These decisions can then be translated back into the departmental baselines. It also means that plans need to be finalised in time to inform decisions, which is usually before the end of each calendar year.
- 4.15 We reviewed the information provided in plans and, generally, were able to reconcile the operating expenditure baselines in the schedules in the four-year plan to the underlying supporting financial information.
- 4.16 It is also important that a department be able to show that information contained in its four-year plan is consistent with other departmental information. This was not always so, and we saw one example where there was no reconciliation between funding as set out in the Estimates and internal forecast funding.
- 4.17 In some situations, the information contained in four-year plans quickly became out of date. For example, budget bids, successful or otherwise, were not included. Information can also become out of date because of the delay between when the four-year plan is prepared (November and December each year) and its potential publication (June or July the following year). The State Services Commission told us that it encourages departments to treat their four-year plan as a “living document” and update them when it is useful to do so.
- 4.18 However, when updating the information in their four-year plans, departments need to ensure that they do so accurately. We found one example of clerical and calculation errors in updated information in the plan. Although these errors were immaterial, they show the need for care when updating.

- 4.19 We identified some minor issues where a department's underlying information was not reflected in its four-year plan. This occurred for several reasons, including:
- individual department business units adopting different methodologies to determine costs, which, in one instance, meant that some business units assumed that they had more funding than was actually the case;
 - not enough consideration of actual business unit costs when preparing overall forecasts; and
 - clerical and calculation errors when updating the four-year plan to take account of successful funding bids.
- 4.20 The sophistication of forecasting tools used in forecasting financial information varied.
- 4.21 One of the four selected departments had a flexible budget forecasting model with assumptions that could be adjusted to perform scenario modelling or sensitivity analysis. This model flowed through to a strategic finance plan that was used as a basis for much of the financial information in the four-year plan. We consider this good practice.
- 4.22 However, we found that budget forecasting was generally not very well developed – some departments lacked a robust financial forecasting system, or the system was not well co-ordinated throughout the department. For example:
- In one department, business units assessed important projects based on their key deliverables, with individual business units preparing subsequent budgets. However, the department did not fully consider these budgets when updating its four-year plan. This meant that we were unable to reconcile the individual business costs with the total costs in the four-year plan.
 - We expect the forecast numbers and assumptions used in four-year plans to provide enough information to understand and assess the funding needed to achieve the department's objectives. This was not always the case. For one department, it was difficult to see how the objectives and goals of the plan were supported in the financial forecasts because the department's financial forecasts did not flow through to the four-year plan.
 - One department adopted a "top-down" approach to forecasting and budgeting that identified the main programmes of work to be completed during the four years. However, the department had not considered the amount of resources needed to complete the projects or whether the proposed timing for specific projects was achievable. This approach also meant that some of the assumptions underpinning the four-year plan, such as staffing levels needed to complete work programmes, were not supportable.

- One department completed a prioritisation exercise to ensure that the four-year plan balanced with the existing budget. This helped the reader understand where the expected costs reductions could be in the department. However, the exercise was performed at a high level and did not provide enough detail about how and when the department would achieve its cost reductions.

Integration of financial information into a department's operational activities, and analysis of choices and trade-offs

- 4.23 Departments should have a good understanding of where their funding is spent, why the money is being spent, and how resourcing will shift to priority areas during the planning period. Four-year plans are designed to help inform government resource allocation and decision-making, including Budget decision-making, by demonstrating the value created with existing funding.
- 4.24 Accordingly, we expect an effective four-year plan to:
- identify the main work streams needed to meet statutory and non-statutory obligations and allocate funding to those work streams;
 - set out analysis of cost pressures, including explaining the effect of cost pressures and how the cost pressures would affect the future service delivery of the department; and
 - provide a detailed analysis of the decisions made about investments and savings, and the trade-offs and prioritisations in service delivery that these decisions involved.
- 4.25 Departments provided some information on their broader sector, including the strategic intentions, financial information, and risks set out for each Crown entity the department monitored.
- 4.26 However, financial information for the non-departmental activities was not always presented to the same level of detail as departmental activities, and broader sector cost pressures were not always analysed in detail. As a result, plans did not always provide a thorough view of the sector's strategic goals nor the financial resources and trade-offs needed to deliver those goals.
- 4.27 Departments identified the main work streams and generally allocated funding to those work streams, but they could improve the way they considered the relationship between service delivery and financial forecasts.

- 4.28 In some plans, it was evident what a department wanted to achieve, but there was not enough consideration of the implications of this in the financial forecasting. For example, one department wanted to increase a service during the following years but had not factored the increased costs into the financial forecasts. (The department considered that any cost increases would be off-set by service revenue increases so would be cost neutral, but our view is that this should have been reflected by showing the increased costs and future revenue increases.)
- 4.29 We also saw some examples of departments including projects for the four-year period in their plans but no detailed information about the prioritisation of these projects or the related costs.
- 4.30 For example, one plan did not provide enough detail about how cost reductions would be achieved or when. Also, there was no detailed information about the work that would be removed and the implications of this on the levels of service the department could provide.
- 4.31 One department explained the trade-offs it was making very well. For example, it used its strategic financial model to make explicit trade-offs in business units, which we consider good practice because it allows the department, the Government, and the central agencies to understand the costs involved in each service delivery option.
- 4.32 However, our observation is that departments generally provided limited information in four-year plans of their service levels and any trade-offs being made in their planning. This means that it was often difficult to identify and assess the trade-offs and prioritisations taking place and circumstances where service delivery might be affected.
- 4.33 For example:
- When four-year plans identified significant funding pressures, they did not always demonstrate how these pressures (where not covered by budget bids) would be managed. In one instance, a department indicated that it was clear that its future financial position was unsustainable and that it was working to identify areas of work that could be stopped, reduced, or redesigned. However, the department provided no further information about what this would mean in practice.
 - There was often limited discussion of trade-offs or alternative scenarios if proposed initiatives or budget bids were declined.
 - It was often unclear how planned reductions in staff numbers would affect levels of service.

- Service-level forecasts did not always include likely changes to a department's or sector's operating environment, demographics, and other factors affecting its work.
 - Some trade-offs and prioritisations in the policy and regulatory environment appeared inconsistently – for example, in some instances, demographic changes were considered only in relation to the effect on the department's workforce retention rates and not the effect on its work programmes.
- 4.34 The lack of a robust assessment of the resource implications and trade-offs a department is making to avoid overspending is a significant weakness of the four-year plans we reviewed. The risks this creates include:
- a department having to unexpectedly reduce service levels or the quality of its service levels because of a lack of funding; or
 - a department exceeding its baseline budget to deliver its agreed service levels.
- 4.35 We saw some good examples of departments being aware of their cost pressures and where their greatest risks were. For example, one department included general inflation increases and contract cost increases in its forecasts. The department understood that about 40% of its costs came from outsourced services and that this would place significant pressures on its operating costs in future years as its suppliers seek to renegotiate contracts. The department was aware of these future cost pressures and considered them in its forecasts.
- 4.36 However, we identified some issues with the way departments analysed cost pressures. For example:
- There was a lack of analysis of cost pressures for non-departmental expenditure.
 - We were not always able to reconcile specific cost increases, such as forecast employment costs, with balances included in the overall cost pressures in the financial forecasts.
 - There was a lack of supporting evidence for some cost estimates.
 - There was a lack of description of what increased costs and spending related to.
- 4.37 We expected that departments that identified short-falls in funding or budget pressures would set out options for addressing these in their four-year plans. However, they did not always do so.

Information about asset management and capital intentions

- 4.38 Information about departments' assets was generally less well developed and we found a range of issues with information about asset management and capital intentions in four-year plans. For example:
- For some departments, the four-year plan discussed asset management planning briefly and at a very high level, with little financial information.
 - There was little detailed analysis of asset management for Crown entities in the department's sector.
 - Some departments included estimated costs for new assets without providing any supporting information, such as underlying information or assumptions, to support the costs.
- 4.39 We consider that the information on capital and asset management currently provided in four-year plans is of limited use from a medium-term planning perspective.
- 4.40 Overall, the less-developed state of sector and asset information means that four-year plans are not yet likely to effectively identify sector cost pressures and risks, and the effect of these on the finances of the Government and the services intended to be delivered to the public in the future.
- 4.41 However, experience in central government in medium-term planning is developing, and focusing on preparing robust departmental plans has been a good first step. During the period that four-year plans have been developing, the Treasury has been introducing a suite of asset management and capital investment improvement initiatives, including recently introducing a requirement for long-term investment plans.
- 4.42 These capital and asset management initiatives should strengthen four-year planning, allowing departments to better incorporate information about sector trends, and capital and asset management intentions.
- 4.43 For the four departments we looked at, Figure 3 shows that, on average, departmental expenditure accounted for only 21% of their total expenditure and departmental assets accounted for only 29% of their total assets. As the more significant, non-departmental information reflects broader sector activities, this shows the importance of including more detailed sector information and financial analysis, to provide a view of that broader sector.

Figure 3
Departmental and non-departmental expenditure and assets for four departments

	Non-departmental total		Departmental total		% that is departmental	
	Expenditure	Assets	Expenditure	Assets	Expenditure	Assets
Ministry of Transport	\$3.3 billion	\$97 million	\$32 million	\$8.2 million	1%	8%
Ministry for the Environment	\$575 million	\$11 million	\$53 million	\$17.1 million	8%	60%
LINZ	\$78 million	\$459 million	\$104 million	\$91.0 million	57%	17%
MBIE	\$3.0 billion	\$706 million	\$582 million	\$341.9 million	16%	33%
Average	\$1.7 billion	\$318 million	\$193 million	\$114.6 million	21%	29%

Source: The departments' annual reports for 2014/15.

How to improve four-year planning

- 4.44 To continue to improve four-year plans, departments need to:
- ensure that the financial information contained in four-year plans is supported by the underlying financial information and is based on reasonable and supportable assumptions;
 - use a robust forecasting model that allows testing of a range of scenarios and their sensitivity; and
 - explain how they will achieve their objectives and strategic intentions, and any trade-offs and prioritisation.
- 4.45 To improve four-year plans, the central agencies need to:
- continue to improve their guidance about preparing four-year plans, including guidance on standard and common financial assumptions, and how the plans are used in the context of the Government's overall financial management system; and
 - work to improve medium-term planning by requiring departments to include information about medium-term planning matters, such as about capital and asset management intentions, covering all Votes and appropriations the departments administer.

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