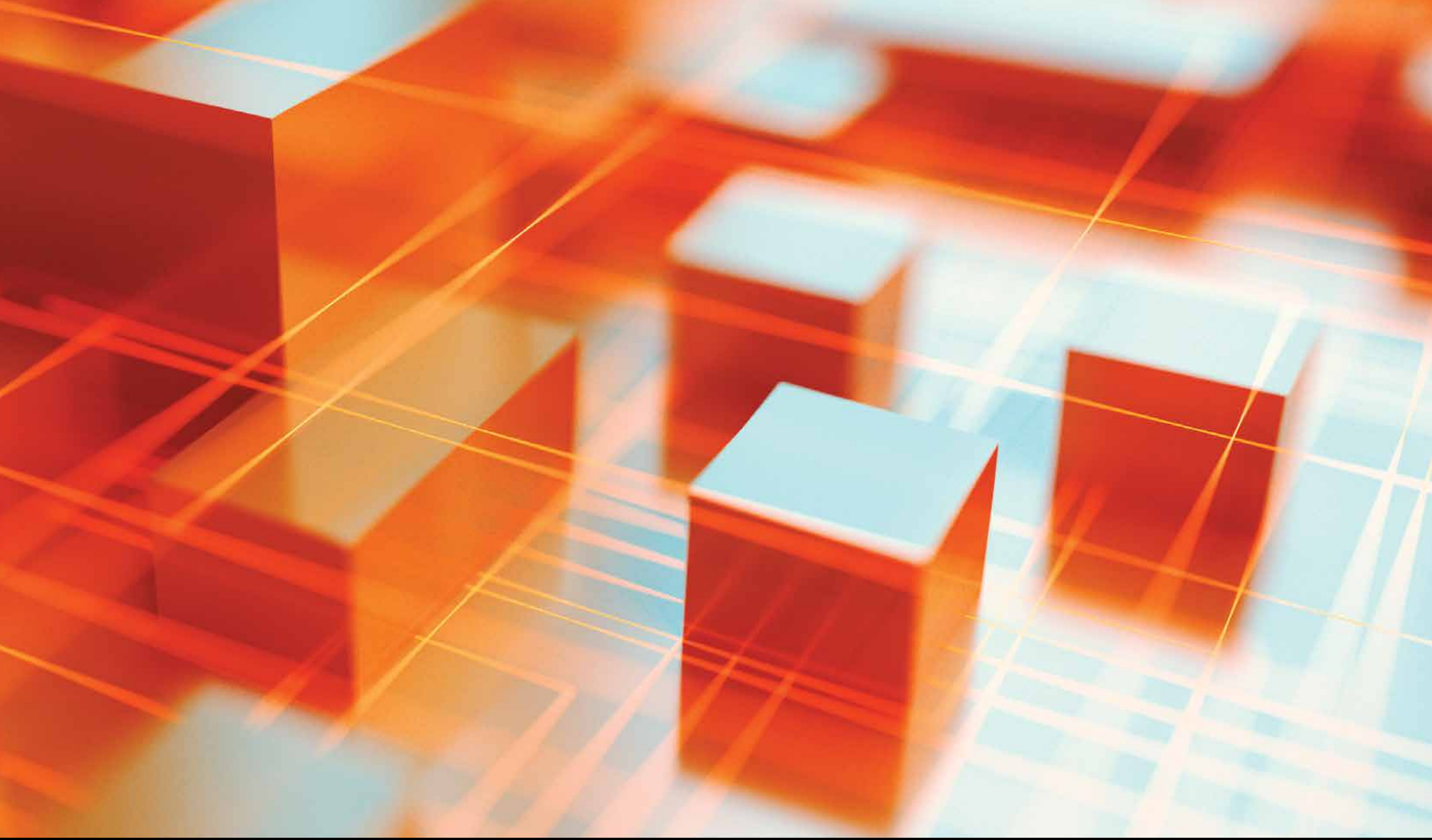

SageBush public finance resources

Developing a strategic financial plan

SageBush's public finance resources support public sector leaders to understand and manage financial challenges.

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SAGEBUSH STRATEGIC (FINANCE) PARTNERS

Purpose of a strategic financial plan

A strategic financial plan (SFP) will set out how your agency will achieve its strategic objectives, deliver its agreed outputs and meet any funding pressures within approved funding levels.

Government agencies operate within tight funding constraints and are expected to meet inflation and other cost pressures by realising efficiencies and reprioritising expenditure. Therefore, they often face funding shortfalls and must modify the roll-out of initiatives, business operations, costs and/or funding levels to enable them to continue to operate within appropriations. The SFP provides the information to make these decisions and to enable progress to be monitored. It forecasts operating costs and revenues, identifies any funding gaps, develops options to address the funding gaps and seeks agreement from senior management to proposed changes.

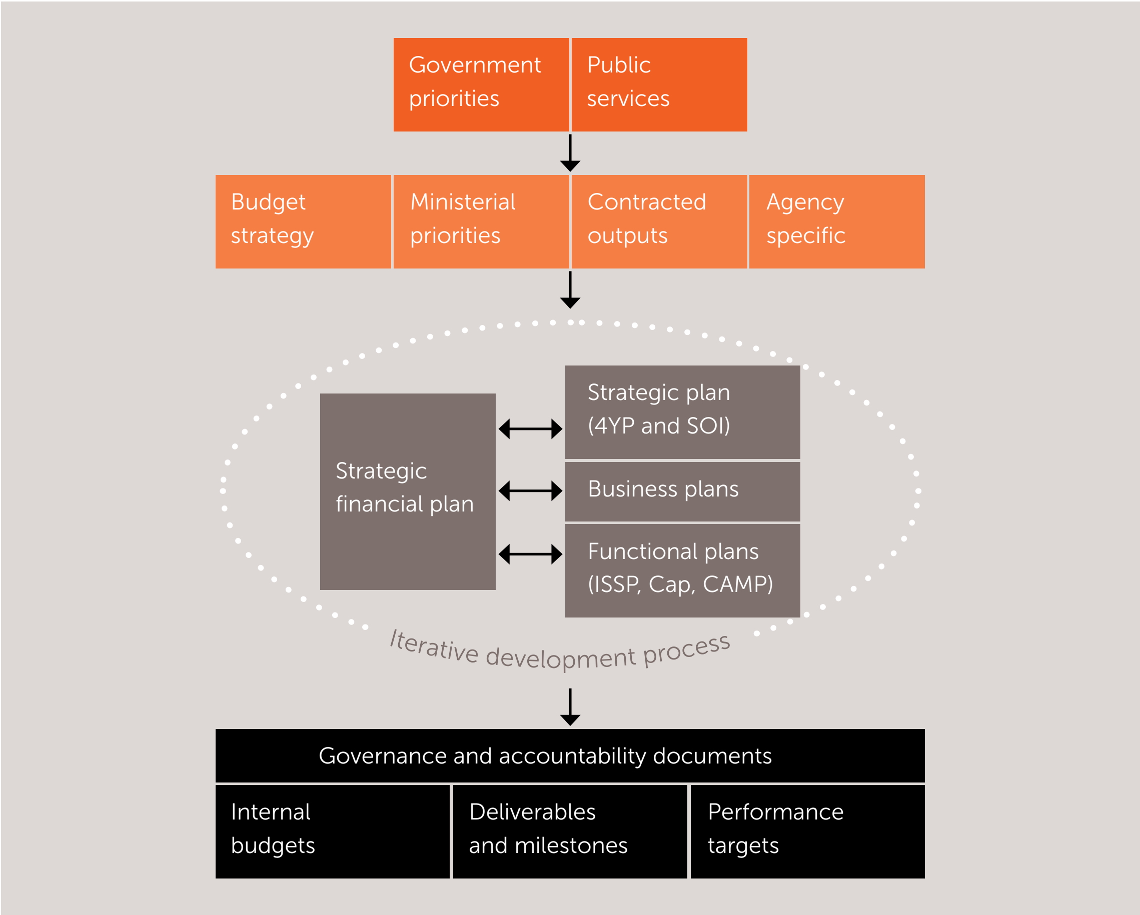
Part of a wider planning process

The SFP should be developed and updated as part of your agency's strategic planning process. The agency prepares a strategic plan in response to government priorities and the ongoing requirement to deliver public services. Other influences may include the current year's budget strategy, ministerial priorities, contracted outputs and agency-specific issues. The strategic plan identifies the agency's strategic intentions or statements of the strategic objectives that it intends to achieve or contribute to. Strategic intentions are documented in the 4-year plan (4YP) and must be published and presented to the House.[1] Business plans and functional plans – such as the information systems strategic plan (ISSP), capability plan, capital asset management plan (CAMP) and others – are developed to support the strategic plan.

The finance team tests whether these plans and other cost pressures can be funded within existing baselines and identifies and assesses options to address any funding gaps. It prepares a complete picture of the agency, its resources, the proposed deployment of those resources, and the outputs produced or public goals that will be achieved. In larger agencies, there may be increased emphasis on capital investment planning, property and asset management. The focus should be on the long term, which should be at least the next 4 years but may be longer, depending on the nature of the agency, its activities, cost drivers and investment requirements.

This information is presented to senior management groups in the agency who must decide on the appropriate funding options and agree to the changes required to operate within approved funding levels. These decisions may in turn require changes to the agency's strategic plan and/or other planning documents. The financial forecasts and actions are updated to reflect the agreed options and become the SFP.

The strategic planning process within an agency should therefore be iterative with decisions on the SFP feeding back into the strategic plan, business plans, functional plans and related governance and accountability documents. Planning documents should not be finalised until a SFP that clearly sets out how the agency will fund its plans has been agreed and the changes have been incorporated into related plans. This process is illustrated below:



[1] This may be done in a number of ways. Options include publishing and presenting the agency's strategic intentions on their own, typically referred to as a statement of intent (SOI), or including them in its annual report or in any other document. Refer Public Finance Act: Strategic Intentions Guidance, The Treasury December 2015 (https://treasury.govt.nz/sites/default/files/2015-12/pfa-si.pdf).

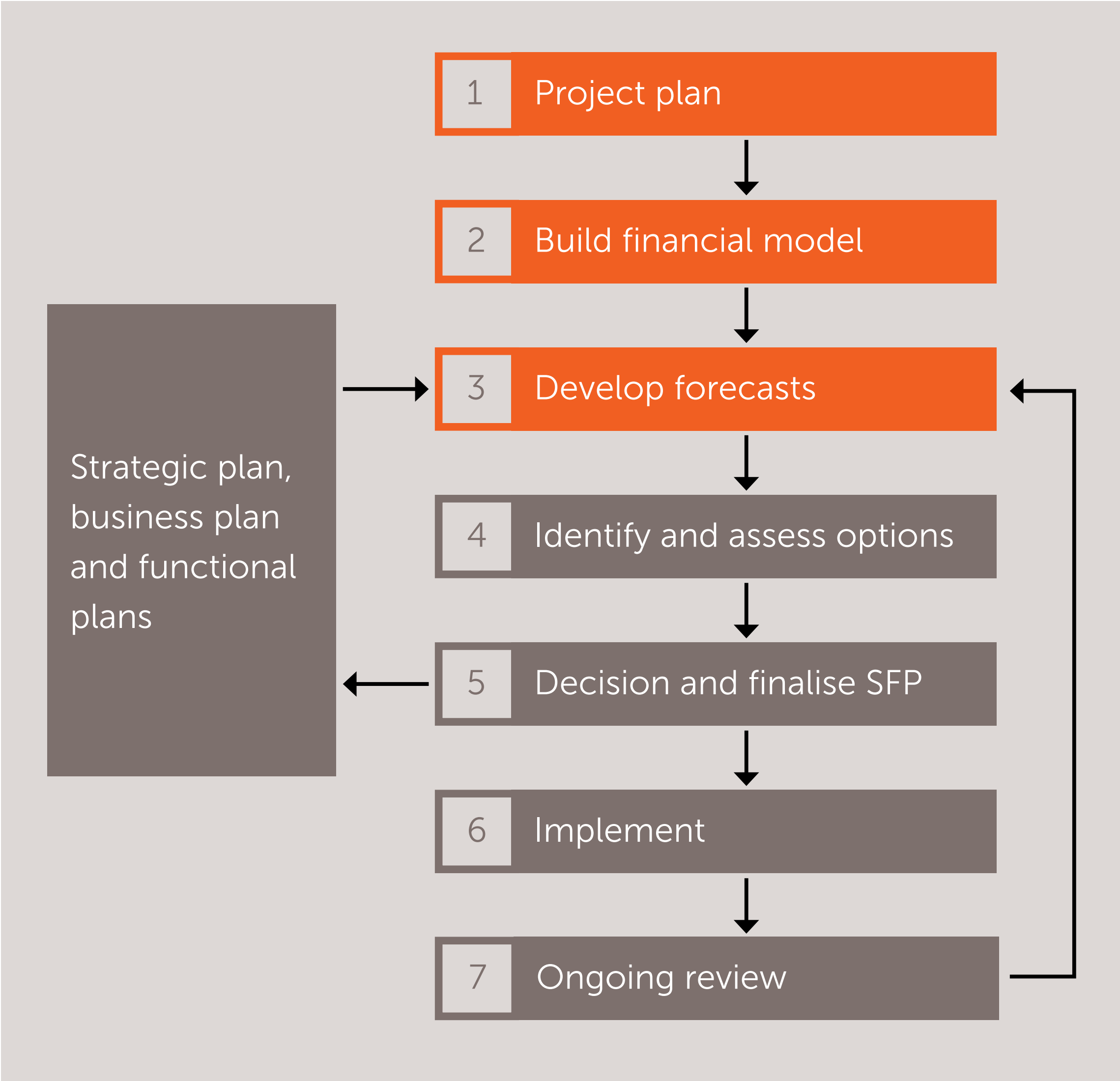
Success factors

Successful development of the SFP will depend on the following factors:

- **Leadership and management support** – ownership, commitment and support of the strategic financial planning process by senior management will ensure agency engagement and willingness to make any required changes to the agency's strategy, operational plans and/or outputs. The SFP must be led and owned by the executive leadership team (ELT), with support from finance (not the other way round).
- **Effective engagement** with senior management and other key internal stakeholders will enable the finance team to understand the challenges facing the agency and the proposed responses to governmental expectations and the public's demand for services.
- **Finance function moving beyond compliance** – the scope and role of the finance function will need to extend beyond compliance and a current year focus to include involvement in business strategies, plans and decisions that will ensure the organisation is successful and financially viable.
- **Sound understanding of business operations** – the finance team will need to identify the key parts of the business and develop a sound understanding of business operations, cost drivers and forecast demand and how these factors may change over time.
- **Quality of analysis** – identification of financial issues and funding options depends on the quality of analysis and assessment. This requires realistic assumptions, robust financial modelling, forecasting, sensitivity and scenario analysis and presentation of options to senior management in a way that allows them to make well informed quality decisions.
- **Quality of supporting information** including budgets, costings, forecasts and non-financial information.
- **Management of benefits** – funding options often hinge on current or future initiatives realising tangible monetary benefits. A successful SFP therefore requires identification of benefits and a clear plan to ensure that they are realised.

How to develop a strategic financial plan

Development of the SFP involves forecasting operating costs and revenues, identifying any funding gaps, developing options to address the funding gaps and seeking agreement from senior management to proposed changes. A seven-step process is used to develop the SFP as follows:



Step 1: Project plan

Development of the SFP is a complex process requiring co-ordination of data, documents, specialist skills, staff and managers across the agency. It also needs to be completed within fixed timelines to allow it to feed into other planning/accountability processes. The SFP should therefore be established as a project and managed under a light-touch project methodology. These are the key steps:

- Confirm the support of the CE and the ELT.
- Agree the scope.
- Identify the agency's outcomes, priorities, goals and outputs for the next 4 years. These will have been set out in the 4YP and SOI in the previous year and will need to be confirmed by the ELT.
- Identify links to the agency's strategic planning process and interdependencies with other documents – 4YP, SOI, business plans, ISSP, capability plan, CAMP, remuneration strategy.
- Identify key documents that will feed into the SFP – draft strategy documents, existing baselines, any subsequent Cabinet approvals.
- Agree key deliverables and timelines for the SFP.
- Develop a work plan, identify the resources needed and assign responsibility for deliverables.

Step 2: Build financial model

A financial model will need to be built to reflect the cost structure of the agency and enable robust forecasting of the costs, revenues and any funding gaps under different assumptions and operating scenarios. This will enable the finance team to identify any funding issues, assess options to address these issues and test the sensitivity of variables. There are two main steps in developing the model:

- Develop and agree the key assumptions. These will guide the forecasting and modelling required for the SFP and might include:
  - expenditure must be within approved funding levels – existing baselines plus any subsequent funding changes agreed by Cabinet
  - forecasts include inflation impacts and volume changes
  - inflation factors for personnel and other costs are based on Treasury estimates
  - revenue derived from fee-funded activities can only be used to fund-related activities
  - replacement capital expenditure is funded internally
  - new initiatives and/or new capital are funded by capital injection.
- Identify the key operating arms of the agency and their cost drivers. Build a financial model that reflects these factors. The model should:
  - reflect the current and future cost and revenue structure of the agency
  - align with the agency's financial statements
  - include the key operating arms of the business in sufficient detail to model changes to key variables
  - allow modelling of changes to key variables such as assumptions, key cost drivers, outputs and business processes
  - allow scenario analysis so that options can be modelled
  - include the current year and at least 4 outyears so that it can support the 4YP.

Step 3: Develop forecasts

The financial model is then used to develop expenditure, revenue and funding forecasts for the current year and outyears. The forecasts should include a range of scenarios:

- **Base case** – existing business operations, including any changes agreed by Cabinet, forecast inflation and work volumes.
- **Scenario 1** – base case plus additional changes proposed in the 4YP and/or SOI.
- **Scenario 2** – scenario 1 plus any additional changes proposed in business plans and functional plans.

Sensitivity analysis should be undertaken for each scenario to test the sensitivity of forecasts to changes in key variables such as assumptions and volume projections. The analysis should cover low, medium and high changes in key variables.

With fixed baselines, forecast cost inflation and proposed new initiatives, it is highly likely that the forecasting will identify funding gaps in one or more of the scenarios. The forecasts will identify the amount and source of funding issues.

Forecasts should be discussed with business groups to verify accuracy, ensure buy-in and incentivise the identification and development of funding options.

Step 4: Identify and assess options

The finance team should work with business groups to identify possible options to address any funding gaps, particularly in their responsibility areas. Consideration should also be given to options that might help to address funding gaps in other parts of the agency. Options could include:

- reducing costs – increasing economy
- redesigning processes – increasing efficiency
- prioritising outputs and reallocating funding – increasing effectiveness
- changing the quantity, quality or scope of outputs
- developing cross-agency initiatives
- increasing funding.

This process will result in a long list of options that need to be reduced to a short list for detailed financial modelling. The long list should be assessed against criteria such as:

- achievability of strategic objectives
- impact on business plans and functional plans
- impact on delivery of outputs – quantity, quality or scope
- risk of not addressing the funding gap.

The assessment process will result in a short list of options that should be analysed using the financial model. The impact on service delivery quality, other outputs and other deliverables should be identified. Each option – or suite of options if they are to be implemented jointly – should allow the agency to operate within approved funding levels.

The finance team should consult with business groups on the assessment of options and agree the preferred option.

Step 5: Decision and finalise SFP

The finance team should prepare a paper for the ELT summarising the financial modelling and any funding issues that have been identified. The paper should outline the options to address any funding gaps and recommend the preferred option. This will need to clearly identify the actions and any changes to the agency's strategy and plans. Significant changes to outputs, deliverables or the agency's strategy may require discussion with key stakeholders such as the responsible minister, Treasury, State Services Commission and/or other interested agencies.

The ELT will need to make decisions on the preferred option, agree the action plan and approve any changes to the agency's strategy and plans. Sign-off of the SFP by the ELT should ensure that fundamental questions of financial sustainability are addressed collectively and are not delegated or left to finance by default to sort out. The finance team then finalises the SFP document reflecting these decisions.

Any changes required in other planning documents (4YP, SOI, business plans, functional plans, agreed deliverables) should be communicated to other business groups as appropriate.

Step 6: Implement

The finance team communicates the SFP to internal managers and clarifies the actions required to implement the plan and ensure that the agency operates within approved funding levels.

Internal budgets are prepared based on the SFP. Monitoring and reporting processes are established to track progress against the SFP.

Step 7: Ongoing review

The SFP should be periodically reviewed to identify the impact of any changes in the agency's strategy, business plans, functional plans, business operations, assumptions or key cost drivers. Where changes have created or reopened funding gaps, the finance team should:

- advise the ELT and the appropriate operational managers
- cycle back to step 3 to identify the size of the funding gap and identify and assess remedial options.

Documenting the strategic financial plan

The process of developing the SFP outlined on pages 6–9 will need to be documented to enable a proposal to be submitted to the ELT and for presentation of the final plan to key stakeholders. An indicative structure for the SFP document is set out below. This is not intended to be definitive – every financial strategy will be different, and the SFP document will need to be tailored to suit.

		Description
Section 1	Executive summary	Summarises the key financial issues facing the agency and the agreed plan to deliver within approved funding levels.
Section 2	Background and context	Sets out the purpose, problem definition, objectives, scope and methodology. Outlines the key strategies and outcomes sought by the agency and the financial, economic and policy context in which it operates.
Section 3	Financial model	Describes the financial model that will be used to forecast operating and capital funding requirements. Documents the key assumptions, business operations, cost drivers, inputs and limitations. This section is intended to provide an understanding of how the model operates, its strengths and limitations.
Section 4	Forecasts	Outlines the forecasts of the agency's revenue, expenditure and capital investment requirements under the base case and other scenarios. Presents a sensitivity analysis and the impacts and risks for each scenario. Includes both operating and capital expenditure. This section should clearly identify the size and cause of any operating or capital funding shortfalls. This will allow the finance team to engage with business groups over funding issues and possible options.
Section 5	Funding options	Documents the process and criteria used to identify and assess funding options. Describes in detail the short list of options,[2] summarises financial forecasts under each option and provides an assessment of the advantages/disadvantages of each. Presents the assessment of the short-listed options against agreed criteria and identifies the preferred option. Identifies the impact of the preferred option on the agency's deliverables and any changes required to the agency's strategy, operational plans and/or outputs. *At this stage, the report stage can form the basis of a paper to the ELT requesting approval of the preferred funding option.*
Section 6	Financial strategy	Once approved by the ELT, the preferred option becomes the financial strategy for the agency. This section provides a detailed description of the financial strategy and summarises the assessment and forecasts.
Section 7	Implementation	Sets out how the agency will implement the financial strategy including any changes required, how these are allocated and a timeline.
Section 8	Reviews	Sets out a review process and timeline.

[2] The long list of options would usually be attached as an appendix.

Please contact us
if you would like to talk
about specific challenges
your agency is facing.

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