Controller and Auditor-General
Tumuaki o te Mana Arotake

Discussion paper

Reviewing financial management in central government

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Auditor-General's overview

Significant fiscal challenges are forcing change in the way central government works. The *Better Public Services Advisory Group Report* of November 2011 recognises these changes and recommends that better services, results, and value for money are needed throughout the public sector.

Cross-functional and cross-sector service priorities and needs mean that the structures, strategies, and operations of the Government and its agencies are being redefined. The Better Public Services Advisory Group emphasises the need for:

- financial flexibility to:
  - ensure that results are in line with priorities;
  - reduce duplication; and
  - improve information systems; and
- stronger leadership, including a more strategic financial management approach from chief executives.

To work out in a co-ordinated way where financial resources are directed, how they are controlled, and, ultimately, what value they create is fundamentally important. Therefore, we wanted to review whether central government's financial management system allows us to understand and manage our financial resources within and throughout government and, if not, what needs to change.

Reviewing the state of financial management

To review the state of our financial management system, we commissioned Ernst & Young to help us examine what best practice looks like and then compare this to the current system – within agencies and throughout government.

It is clear from our review that, overall, the financial management system remains on par with many other developed countries (such as Singapore, Denmark, the United Kingdom, and Australia), but it is also clear that there is room for improvement:

- Although there are pockets of strong financial management practice, government remains focused on providing financial control, budget management and external reporting.
- Information sets and supporting processes that help establish how well financial resources are transformed into results (a key component of financial management referred to as "value management") are not in place or not widely used.

- Although the legislative and regulatory frameworks that govern financial management appear to be sufficient, the Better Public Services Advisory Group Report and others suggest that these may not be enough to manage financial performance throughout organisations or sectors.
- External governance and leadership expectations are fundamental to achieving sustainable change but capability, systems, processes, and data are critical to delivering strong financial management. Because of this, the role and effect of central agencies are particularly important.

The above observations should not be surprising. Speaking in November 2010, Gabriel Makhlouf, now the Secretary to the Treasury, observed that there was:

> ... *inconsistent buy-in and ownership of state sector performance by organisations* ...[1]

The challenge now facing us is how to make our financial management system even more effective and the financial information that underlies it more useful and used.

Meeting the challenge

We consider that there needs to be a focus on building a capability to manage value and integrating it in a way that helps in making decisions at all levels. This should build on the solid foundations of other financial management practices, and includes:

- improving the awareness and recognition of the value of stronger financial management within public entities and throughout sectors and the whole of government;
- enhancing the quality, analysis, and usability of the information needed to properly understand and show financial performance, from financial cost to results; and
- combining and putting in line information throughout sectors, functions, and the whole of government.

Central agencies should keep building on their current initiatives and address how they can better co-ordinate and align their respective roles in the financial management system.

Finally, my Office is committed to playing its part in the financial management system and in promoting stronger financial management practices throughout the public sector.

1 The Treasury (2010), *Public Sector Management: A Treasury perspective on contracting for outcomes and managing risks*, Wellington.

I thank Ernst & Young for their work and advice, the officials and other people that we interviewed as part of our review, and the Treasury and State Services Commission for their input.

Lyn Provost
Controller and Auditor-General

22 June 2012

Part 1
Managing financial performance

1.1 In this Part, we discuss what financial management is and why it is important, and summarise our main observations about the state of financial management throughout central government.

Introduction

1.2 Internationally, New Zealand's public management system is seen as a world-class model. We are:

- ranked first in Transparency International's latest Corruption Perceptions Index;
- in the 90th percentile for all of the World Bank's Worldwide Governance Indicators;
- placed second in the Stanford Center for International Development's Sovereign Fiscal Responsibility Index; and
- ranked third for institutional strength and 25th overall in the World Economic Forum Competitiveness indicators.

1.3 The latest Kiwis Count Survey, published in 2010, shows that New Zealanders perceive the public service as offering good value for tax dollars spent.

1.4 However, within this system, there have been persistent calls for financial management to move beyond financial control and external accounting, and to provide a more strategic platform. This means working throughout government to align and allocate resources through a cycle where "plans would inform budgets and results would influence plans".[2]

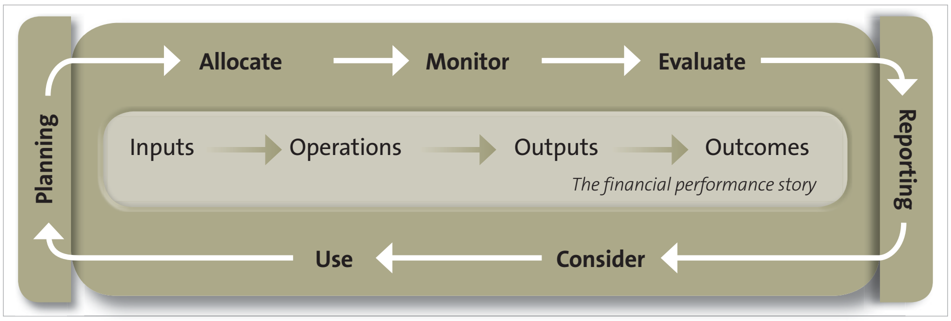
1.5 In 2008, a Treasury survey highlighted many challenges facing financial management in the public sector. The survey's results showed that the move from "fiscal discipline" to ensuring effective and efficient uses of resources was far from complete. In 2010, Ernst & Young surveyed government finance and concluded that, although progress had been made in embedding financial discipline, there were "consistent and significant gaps in capability".

What is financial management?

1.6 Financial management is a significant part of public sector management. Financial management supports the design and demonstration of an organisation's financial performance story – from financial cost to results or consequences (see Figure 1).

2 Schick, A. (1996), *The Spirit of Reform: Managing the New Zealand State Sector in a Time of Change*, State Services Commission, Wellington, page 53.

Figure 1
The financial management process

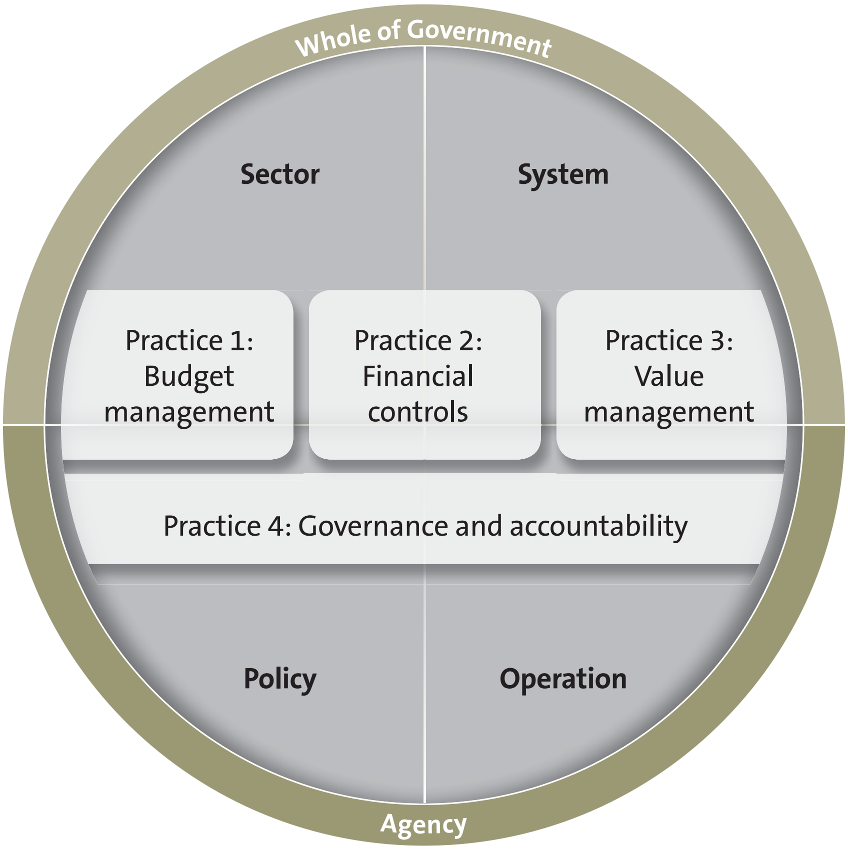


1.7 An effective financial management system provides the right information at the right time to the right people (the supply side) and ensures that the information provided is considered and then used to inform the decisions of those who require it (the demand side).

1.8 Financial management involves establishing what financial resources are available and determining where they are to be directed, how they are supervised, and, ultimately, what value they create – all in a way that is understood and used in managing the financial performance of the organisation. Effective financial management allows stakeholders to understand and control how well the organisation plans for and uses its financial resources to meet the needs of those stakeholders.

1.9 In central government, there are four main financial management functions or "practices" that need to operate within individual public entities (at the policy and operational levels) and throughout the whole of government (see Figure 2).

Figure 2
Financial management in central government



1.10 The four inter-related practices of financial management are:

- budget management – managing the sources of funding and expenditure, and allocating those resources in line with organisational priorities and expected financial performance;
- financial controls – the rules, processes, and procedures that address risks and ensure that financial resources are being recorded and used in the right way, for the right purpose, and at the right time;
- value management – measuring, prioritising, and allocating financial resources based on the expected cost-effectiveness or value for money (VFM) to be derived (sometimes termed "performance management"); and
- governance and accountability – roles, responsibilities, delegations, and structures for making decisions, through which strong financial management can be introduced, practised, reported, and evaluated.

The value of strong financial management

1.11 The value of strong financial management is not based how many plans, budgets, and accounts are produced. As a system, financial management connects the effort of individuals with a public entity's performance, the public entity's performance with overall outcomes, and overall outcomes with the needs of stakeholders.

1.12 A strong and integrated financial management system:

- *builds a better "collective intelligence"* and, in doing so, provides more accurate, relevant and timely information to decision-makers at all levels;
- *motivates better discussion and decision-making* by setting the necessary accountabilities and communicating them to internal and external stakeholders;
- *supports a more flexible and responsive organisation* by promoting continuous improving and an effective workplace where learning takes place; and
- *encourages a more co-operative approach* to work throughout the organisation by helping to break down barriers to collaborating, such as information hoarding and an inward-looking territoriality.

1.13 Working through many public entities with multiple outcomes and stakeholders, these attributes touch on every aspect and activity of government. They underpin effective and efficient allocating and delivery of public services, promote a collaborative spirit, and encourage more public participation and trust.

1.14 Strong financial management provides the platform for three of the five building blocks (or criteria) that underpin our decentralised model of the public management system. These three are accountability, effective assessment of performance, and adequate information flows – the other two being the freedom to manage and clarity of objectives. These building blocks are crucial in motivating initiative, responsibility, and flexibility within public entities while maintaining a wider, more co-ordinated performance perspective throughout sectors, functions, and the whole of government. As the Treasury put it in 1987:

> *... the absence of any one is likely to allow decision-making inconsistent with a given set of objectives, and if all criteria are met, efficient management will be achieved.*[3]

3 The Treasury (1987), *Government Management: Brief to the Incoming Government 1987*, Volume I, Wellington.

A summary of our review of financial management practice

1.16 Our review, completed in February 2012, covered four main areas:

- what is considered "best practice" financial management within and throughout government;
- how the financial management system in central government in this country compares with public sectors in other countries and what lessons can be drawn from looking at the private sector;
- the state of our financial management system, using interviews and discussions with officials, chief executives, and chief financial officers (CFOs) throughout government; and
- the roles and responsibilities of working within and maintaining our financial management system.

1.17 Overall, our review shows that our public sector continues to lead the world in the essential areas of budget management, financial control, and external reporting. However, it is also apparent that, as a system, financial management within public entities and throughout central government could be significantly better.

1.18 The most relevant and positive aspects of financial management practice include:

- the frameworks (legislative and regulatory requirements) that govern financial management are largely enough at a public entity level;
- chief executives and CFOs have responded to incentives and understand well what constitutes good performance in budget management, financial control, and external reporting;
- there are pockets of advanced financial management practice throughout government; and
- there are central agency projects such as the introduction of Four-year Budget Plans and the Performance Improvement Framework that seek to improve financial management further.

1.19 The most relevant and challenging aspects of financial management include:

- central agencies' limited emphasis on value management within and throughout government;
- a lack of clarity about governance and responsibility for the financial management system throughout central government;
- accountability structures that are not co-ordinated throughout government and fail to encourage agencies to introduce strong value management practices (through either reward or sanction);

- the continuing narrow role of CFOs, which reflects a perception that financial management is about financial control, managing budgets, and external reporting; and
- various initiatives (for instance, Managing for Outcomes) to address perceived weaknesses in financial management that are not being embedded throughout government.

1.20 These challenges to strong financial management result from a complex interaction of many elements that characterise a decentralised public sector. Many of these challenges have been noted in the reviews of the public sector management system. When taken as a whole, they show a system with a base of infrastructure, processes, and legislative support that needs extra focus and investment.

1.21 It is clear that single initiatives will not resolve these challenges. Progress will be achieved through determined, strong, and sustained leadership from senior officials, public entities, and Ministers. There are important implications for the Treasury, including the need to:

- reconfigure Treasury's role as CFO of government;
- understand what strong financial management entails and how well it is practised within and throughout agencies; and
- use a range of appropriate interventions depending on the risks and opportunities.

1.22 The following Parts of this paper provide further detail about our approach to the review, our observations, and the inferences that we drew.

Part 2
Best practice financial management in government

2.1 In this Part, we summarise what best-practice financial management is and the factors affecting how it is implemented within and throughout government.

Strong financial management practices

2.2 The financial management system underpins good government and good business. It does so by ensuring that (internal and external) stakeholders can understand and control how well an organisation plans for and uses financial resources. In practice, this means that the right information is provided at the right time to the right people (the supply side) and that the information provided is then considered and used in understanding and controlling the organisation (the demand side).

2.3 As Figure 2 shows, there are four main practices of financial management:

- budget management;
- financial controls;
- value management; and
- governance and accountability.

2.4 Each practice consists of certain inter-related activities, reliant on, and made possible by, a solid foundation of the other activities.

2.5 **Budget management** means managing the sources of funding and expenditure, and allocating those resources in line with organisational priorities and their cost effectiveness. The main prerequisites for managing budgets include understanding:

- sources of funding, and lining these up with outputs and outcomes;
- long-term strategy, priorities, and how to prioritise;
- how cost-effective activities are in achieving desired outcomes; and
- how to comply with central government budget submission and review processes.

2.6 Effective budget management happens when funding and expenditures are in line with strategic priorities and based on a clear understanding of performance expectations.

2.7 **Financial controls** mean rules, processes, and procedures that address risks and assure that financial resources are being recorded and used in the right way, for the right purpose, and at the right time. The main prerequisites for financial control include understanding:

- the requirements of Parliament, Ministers, internal audit, external audit and central agencies;
- risk management and controls of the organisation, and their potential costs and benefits;
- how capital and operational risks relate to the organisation's risk framework; and
- accountabilities at each level of financial delegation and known tolerance levels.

2.8 Financial controls are more than just a compliance exercise. CFOs are expected to have a strategic understanding of the main organisational uncertainties, their potential costs and benefits, and the plans needed to avoid, mitigate, or benefit from them.

2.9 **Value management** means measuring, prioritising and allocating financial resources based on the expected cost-effectiveness or value for money (VFM) to be derived. Value management is sometimes called "performance management". Its main prerequisites include understanding:

- the public entity's mandate, sources of funding, and how that funding relates to activities and outputs;
- the chain of activities that the public entity performs and how these help achieve outcomes or strategic goals;
- the information sets, supporting processes, and leadership required to assess, continuously improve, prioritise, and make decisions about investing and disinvesting options; and
- whole-of-government, sector, and organisational strategies, supported by integrated financial planning and forecasting.

2.10 Value management occurs within public entities and throughout the whole of government (the "system" level). It includes those practices referred to as "strategic financial management" and makes transparent how well financial costs are transformed into services, outputs, and outcomes.

2.11 **Governance and accountability** mean roles, responsibilities, delegations, and decision-making structures through which strong financial management can be introduced, practised, and overseen. The main prerequisites for governance and accountability include understanding:

- the frameworks for stewardship and making decisions;
- the accountabilities at each level of financial delegation and the relevant accountabilities outside the organisation; and
- the performance management framework and how effective financial performance reporting helps decision-makers and managers to monitor and manage assessment.

2.12 Governance and accountability is important in financial management. Without structures and processes in place to make decisions at the right level, managing financial performance is more difficult and prone to risk.

Factors affecting strong financial management

2.13 The ability of each of these four practices to work together as an effective financial management system will depend on the circumstances affecting the supply of, and demand for, strong financial management.

2.14 Three factors that affect the **supply** of financial management are:

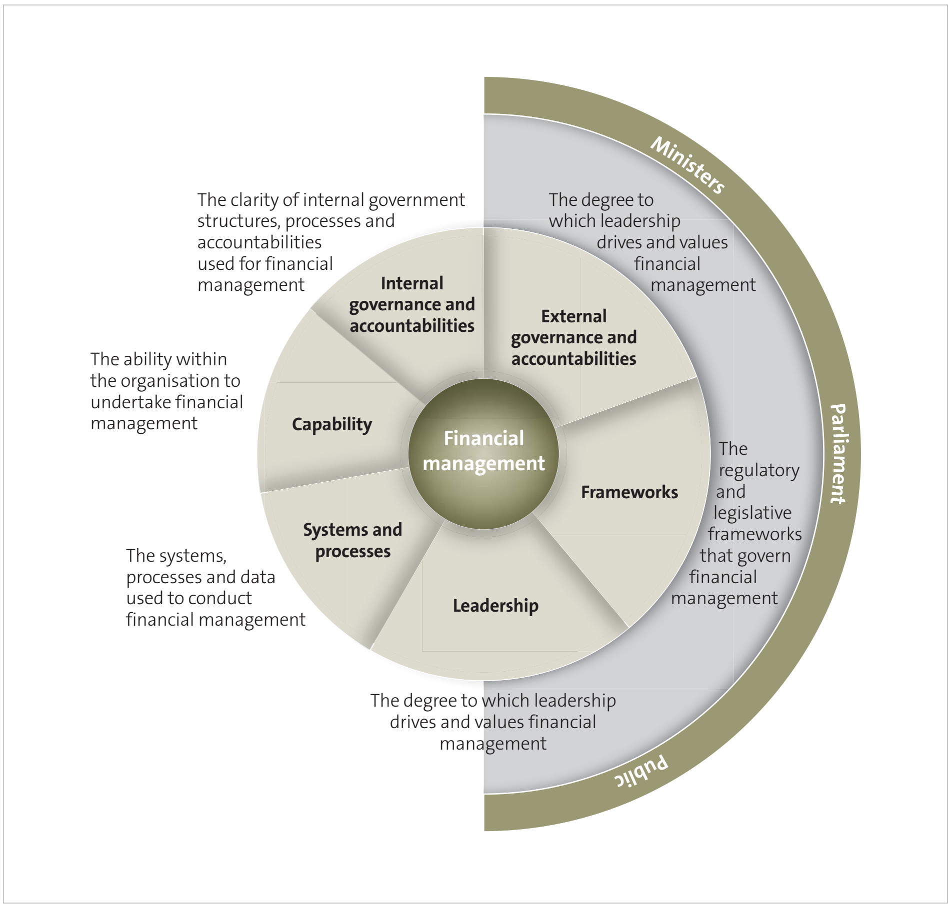
- process, systems, and data;
- capability; and
- leadership.

2.15 Three factors that affect the **demand** for financial management are:

- internal governance;
- external governance; and
- central government financial frameworks.

2.16 As Figure 3 shows, Ministers, Parliament, and the public indirectly support the demand for strong financial management as a means of ensuring confidence and trust in the goods, services, and advice that they get.

Figure 3
Financial management drivers and indirect support



Part 3
Observations from the public and private sectors

3.1 In this Part, we provide some comparisons with other public sectors (Singapore, Denmark, the United Kingdom, and Australia) and set out some lessons from financial management practices in large private sector organisations.

Observations of other countries' public sectors

3.2 The global financial crisis has led to more emphasis on financial management in the public sector. Overall, New Zealand compares well with other countries. Our main observations included:

- The frameworks for financial management in New Zealand are more robust and relevant than many of the other countries. The financial frameworks in other countries are not well designed for dealing with delivery chains that span departments and agencies. Early work is under way, particularly in the United Kingdom, to attempt to address this.
- In 2006, Singapore's government established mandatory VFM-based audits for all central government and statutory boards of government. The VFM framework is overseen by Singapore's Accountant-General in partnership with the country's Ministry of Finance. The United Kingdom's National Audit Office performs similar, independent VFM reviews.
- Although many countries want more sophisticated, strategic financial management, they find it difficult to move from what is seen as a compliance and control function towards a value management and performance framework.
- Many governments face significant challenges understanding (and, therefore, managing) the costs of service and successfully integrating financial and performance information with reporting.
- Most governments' capability levels are similar to New Zealand's. Countries find it difficult to recruit and retain staff with the required skills to deliver strong financial management, within and outside finance teams.
- The role of the chief financial officer (CFO) is largely similar. However, in Singapore "Finance Directors" (the CFO role) sit with the chief executive on the senior leadership team and are seen as third in line after the Director of Policy and Strategy.

Lessons from private sector practices

3.3 Overall, financial management practice in the public sector and in the private sector differ significantly. The private sector has an advantage in having clearer performance drivers (for example, the profit motive) and a much better understanding of the practice of performance management.

3.4 CFOs consider themselves as "Chief Performance Officers", leading a team of skilled finance, planning, and performance improvement specialists, with a wide mandate to work with the business to improve value.

3.5 A summary of the private sector's financial management attributes include:

- Financial management acumen is culturally valued and seen throughout most parts of the organisation as a significant set of skills to advance. Chief executives and CFOs set the tone on the organisation's financial management culture and attitude to the customer, cost consciousness and value creation.
- The premium placed on financial management acumen and skills in senior management is reinforced through having clear personal and unit-level key performance indicators linked to budget management, cost containment, revenue growth, and profitability measures.
- CFOs are part of the senior executive team, and the finance team's main role is to scrutinise and challenge the business not just to report on the numbers. They are seen and act as a catalyst for change.
- There is a single point of accountability for strategy, planning, budgeting, and business improvement.
- The budget is regarded in almost contractual terms – that is, achieving the financial performance metrics is essential to externally measuring organisational performance, especially for organisations listed on the capital markets. This creates an environment in which budgets and forecasts are strongly in line with the communicated organisational strategy and the sense of ownership of budgets and forecasts is strong.
- There are robust internal accountability and governance provisions for major capital allocation and reprioritisation processes. Appropriate and rigorous risk management structures are critical in making effective decisions at the governance level.
- The calibre of financial literacy in large corporate boards is high, and management teams are motivated to ensure that financial information provided to the governing body is comprehensive, relevant, and timely.

Part 4
Reviewing the components of central government's financial management system

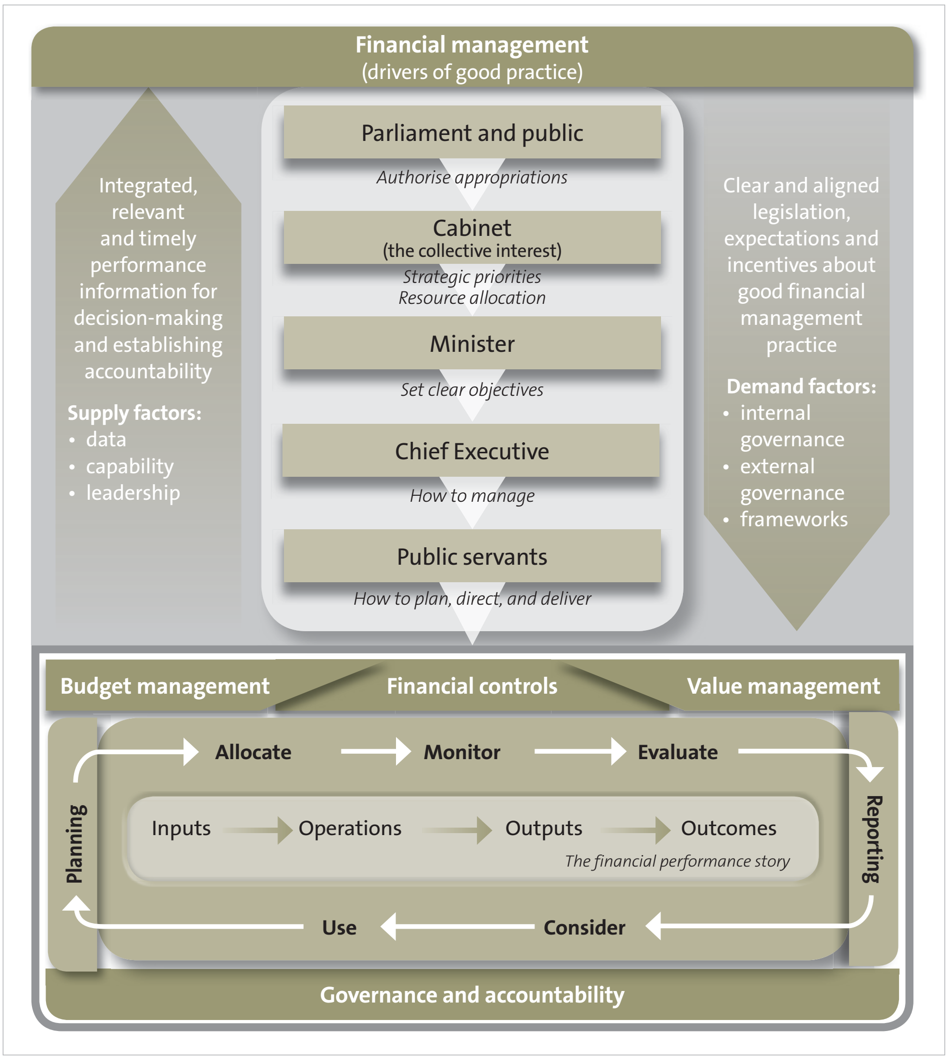
4.1 In this Part, we set out the approach used to assess the state of financial management practice. This assessment was completed in February 2012, and summarises the main observations.

The review methodology

4.2 Reviewing the effectiveness of financial management in central government involves understanding how the demand for, and supply of, financial management affect the four financial management practices of budget management, financial controls, value management, and governance and accountability.

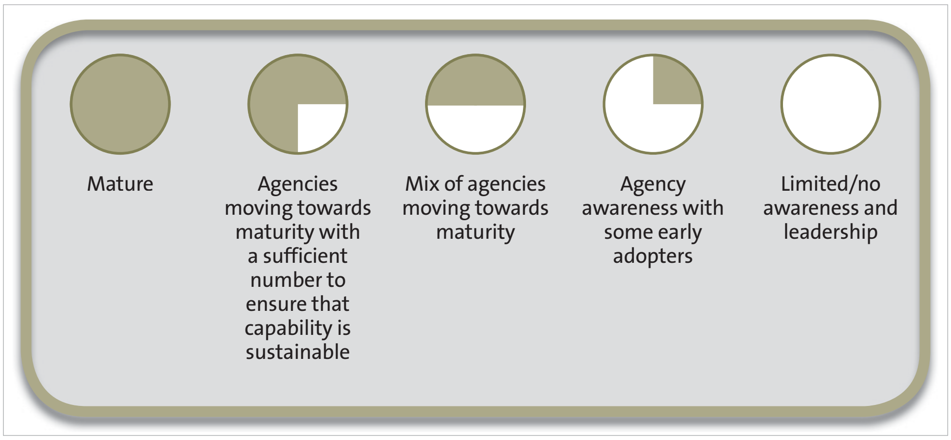
4.3 This approach is summarised in Figure 4.

Figure 4
Factors that affect the demand and supply of strong financial management



4.4 We used interviews and working group discussions with officials, chief executives, and CFOs in government agencies, and applied the maturity model scale illustrated in Figure 5 to describe central government's overall standing in each of the four practices of financial management (as set out in Part 2).

Figure 5
Maturity model scale



4.5 The following sections summarise our main observations about the strengths and weaknesses of each of the six demand and supply-side drivers of financial management shown in Figure 4, and what these mean for the four practices of financial management.

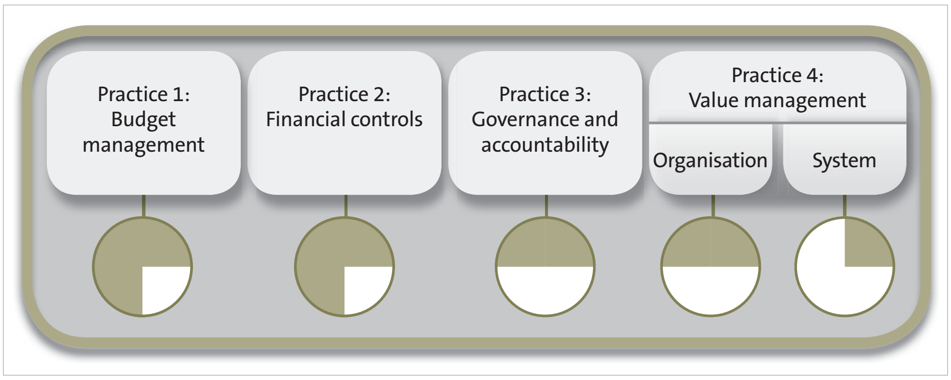
4.6 The practice of value management is assessed at an organisational and a system (or whole-of-government) level.

The framework for financial management

4.7 This includes the legislation and regulations governing financial management, which set requirements for budget management, monitoring and control, and value management.

4.8 Although the current frameworks set clear expectations and accountabilities for financial management in individual public sector entities, they do not easily allow for collaborative work between public sector entities where budgets and resources need to be reallocated to support projects.

Figure 6
Stage of maturity – Frameworks



4.9 **Strengths of frameworks** are:

- Legislation and guidance is evolving and spans the breadth of financial management, providing clear rules and expectations for, among other things, value management practices.
- Budget management, financial controls, and external reporting are integral parts of public sector financial processes.

4.10 **Limitations of frameworks** are:

- Government includes a wide range of agencies with different organisational roles, mandates, and capacity. The size and breadth of each organisation's role can significantly affect how it can introduce financial management practices and prerequisites.
- The previous short-term focus of the frameworks governing planning, budgeting, performance, and reporting may adversely affect public entities' capability for longer-term and more strategic financial management.
- The required planning documents (for instance, Statements of Intent) provide a mechanism to support reporting but not for encouraging or achieving value management practices.
- Although value management is fundamental to the budget process, the budget process alone cannot stimulate value management.

4.11 **Recent initiatives for frameworks** include:

- Budget 2011 introduced Four-year Budget Plans (capital and operating), including identifying low-priority spending and significant options for reprioritisation.

- Introduction of Better Administrative Support Services, which provides benchmarking services to support VFM assessments, target-setting, and tracking of improvement over time.
- Introduction of the Cross Agency Initiatives Process to support assessing of, and investing in, work involving more than one public entity.

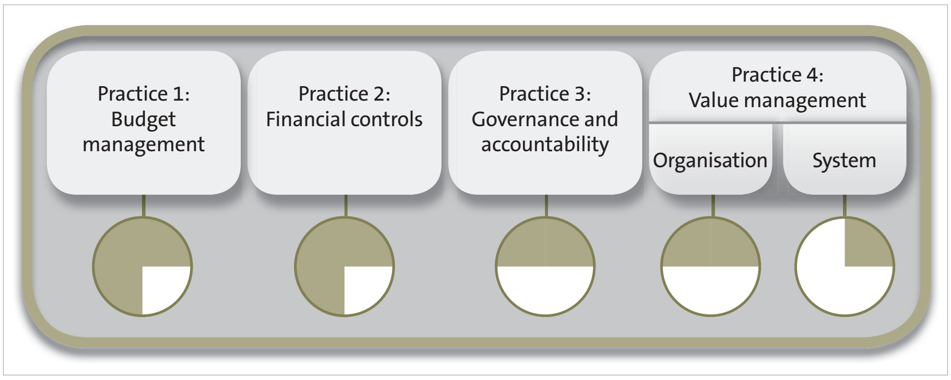
External governance

4.12 External governance covers the structures and processes involved in addressing the stewardship role of, and accountability to, external stakeholders such as Ministers, Parliament, and the public. Among other things, external governance is supported through the quality of the help and guidance that central government agencies provide.

4.13 External stakeholders will always have different perspectives. The inherent tensions that result are a fundamental part of the fabric of government. The tensions can be a source of strength and weakness for the financial management system, which, therefore, must be managed to ensure that it reflects, but does not seek to represent, every perspective.

4.14 Although public entities have at times been clear in their demand for, and focus on, wider financial management, their effective focus has been largely on budget management, financial controls, and external reporting. This has played a part in narrowing the practice of financial management throughout government.

Figure 7
Stage of maturity – External governance



4.15 **Strengths of external governance** are:

- Central agencies and the Auditor-General have clear and specific responsibilities for financial and performance management practices.
- A significant suite of guidance material has been produced and published by central agencies and the Auditor-General.
- There is established support and advice to agencies for budget management and control.

4.16 **Limitations of external governance** are:

- The Treasury and the State Services Commission have discrete responsibilities for aspects of financial management, but have unclear roles and accountabilities in value management and the overall financial performance of public entities.
- Central government agencies' financial management focus and accountability processes are heavily weighted towards budget management, financial controls, and external reporting.
- Apart from publishing and disseminating guidance and setting up information sharing forums, there is little building of public entities' capability and understanding of strong financial management practice.
- There appear to be no visible consequences (or benefits) for chief executives (or the agencies themselves) for poor (or strong) financial management practice.

4.17 **Recent initiatives for external governance** include:

- The processes and structures supporting the Better Business Case Guidance begin to move guidance material away from being static documents towards more interactive opportunities for growing capability.
- The publication of the Investment Statement of the Government of New Zealand provides an overview of the significant assets and liabilities on the Crown's balance sheet, how they have changed over time, and how what the Crown owns and owes is forecast to change over the next five years.

Internal governance

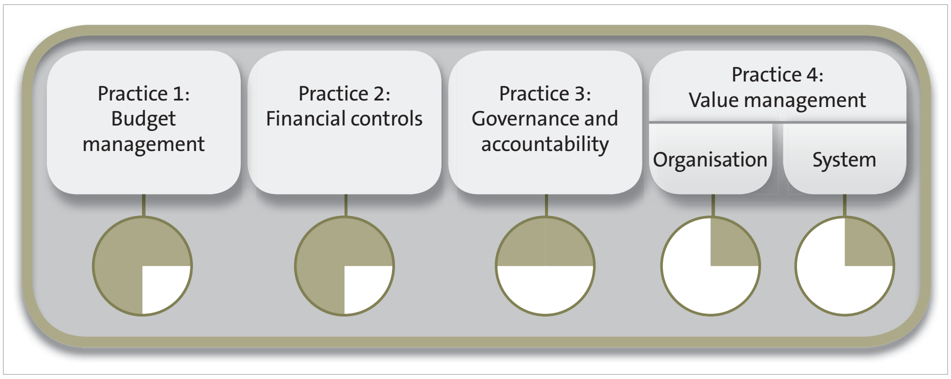
4.18 Internal governance considers the structures, processes, and accountabilities that the executive of the agency uses to manage and overview the organisation.

4.19 Internal governance processes, such as the development of strategy, planning, and budgeting, should translate the strategic intent of the organisation into activity. This translation should be the subject of internal controls to determine whether it is providing value for money.

4.20 Internal governance throughout government is generally effective and provides robust assurance for, and oversight of, the financial management practices of budget management and financial control.

4.21 However, governance and accountability in relation to value management is unclear and confused. There was often a lack of internal processes to help understand and establish accountability for achieving the practices, prerequisites and outcomes of strong financial management.

Figure 8
Stage of maturity – Internal governance



4.22 **Strengths of internal governance** are:

- There are generally sound structures and accountabilities in place to effectively govern budget management and financial controls.
- A few public entities have combined accountabilities for planning, preparing strategy, budgeting, reporting performance, and improving business.

4.23 **Limitations of internal governance** are:

- Accountabilities for planning, preparing strategy, budgeting, reporting performance, and improving business are often split among many teams and throughout the organisation.

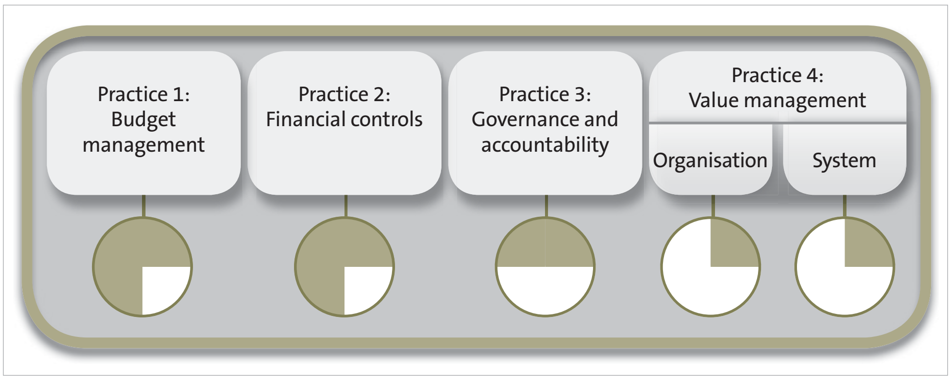
- Budgeting and planning processes are often not in line with time frames.
- Output specifications are often not linked with the planning and budgeting process.
- VFM and cost-effectiveness projects are often set up as one-off initiatives rather than part of core (business as usual) accountabilities.
- Financial management is limited by the creation and/or existence of many governance structures with unclear mandates, accountabilities, ownership, memberships, and insular reporting requirements.
- The risk management and analysis done through governance structures is not proportional to the risk and expenditure or linked activities involved in delivering services.

Leadership

4.24 Leadership looks at the degree to which senior officials in the public sector influence, motivate, and appreciate strong financial management.

4.25 Leaders acknowledged and strongly supported the need for better financial management, especially value management. However, they were not always clear what this meant in practice or what strong practice looked like. Financial management and developing capability in their organisations was not always a top priority for many public sector leaders, who often focus more on managing policy and the political environment.

Figure 9
Stage of maturity – Leadership



4.26 **Strengths of leadership** are:

- Most leaders recognise that current financial pressures mean that it is most important to focus scarce resources on priority areas and significantly improve efficiency and effectiveness.

- Many leaders have stated that their organisations have made progress in understanding what is valuable to them and in identifying VFM gains as they arise.

4.27 **Limitations of leadership** are:

- Most leaders recognise that their organisations have to make significant changes to fully understand and embed the full set of financial management practices. Limitations include lack of:
  - capability;
  - integrated business intelligence and data;
  - awareness of responsibilities that cover more than one public entity; and
  - wider organisational understanding of how to assess and achieve VFM.
- Some leaders see the current VFM focus as temporary and more about other sectors and spending that is unrelated to their organisation.

4.28 **Recent initiatives for leadership** include:

- Budget 2011 announced that agencies would be required to deliver an "efficiency dividend" of between 3% and 6%, depending on the size of the agency. This dividend is intended to drive ongoing efficiency and productivity improvements and to generate savings alongside the move to four-year budget plans.
- In September 2010, the Performance Improvement Framework was introduced as an evaluation of practices, systems, and processes in public entities. The evaluation includes assessing leadership, direction and delivery, and financial and resource management. The financial and resource management section is being upgraded to recognise, among other things, the benefits of sustained integration and use of performance information.

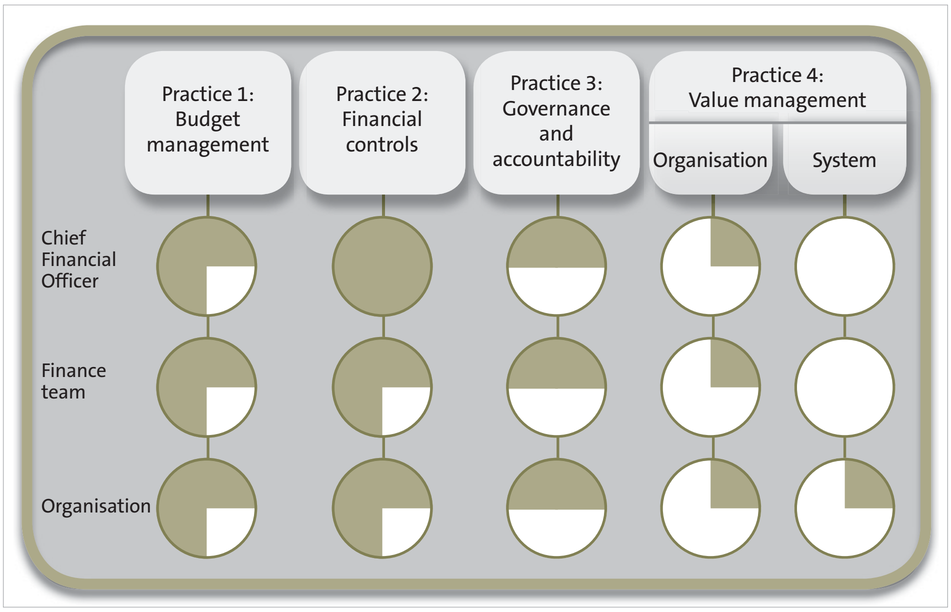
Capability

4.29 Capability refers to the skills and experience that provide capacity within the public sector to perform good financial management.

4.30 Most agencies have the skills and competence needed for budget management and financial controls. However, few have the skills and experience required for the full set of financial management practices at both agency and system levels.

4.31 The role of the CFO needs to be moved from that of Financial Controller (focusing on budgets and controls) to that of "Chief Performance Officer", focusing on value management and financial performance, in line with leading private-sector practice.

Figure 10
Stage of maturity – Capability



4.32 **Strengths of capability** are:

- In general, finance teams are able to manage budgets and control finances well.

4.33 **Limitations of capability** are:

- In most public sector organisations, the CFO is a "financial controller" whose focus is on managing budgets and reporting rather than value management, improving performance, or being an agent of change.
- Few CFOs and finance teams have the mandate, capability, or capacity to carry out some more sophisticated financial management, such as cost-benefit analysis, VFM or efficiency assessments, process design, or re-engineering techniques.
- Many CFOs lack the experience of building the required systems, processes, and finance teams to introduce and incorporate value management practices.
- Outside finance teams, financial literacy and capability is limited.

4.34 **Recent initiatives for capability** include:

- The Treasury holding a CFO forum to share good practice and methods among public entities.
- Improved functional leadership responsibilities through the Government Chief Information Officer and centres of expertise for managing property and procurement.

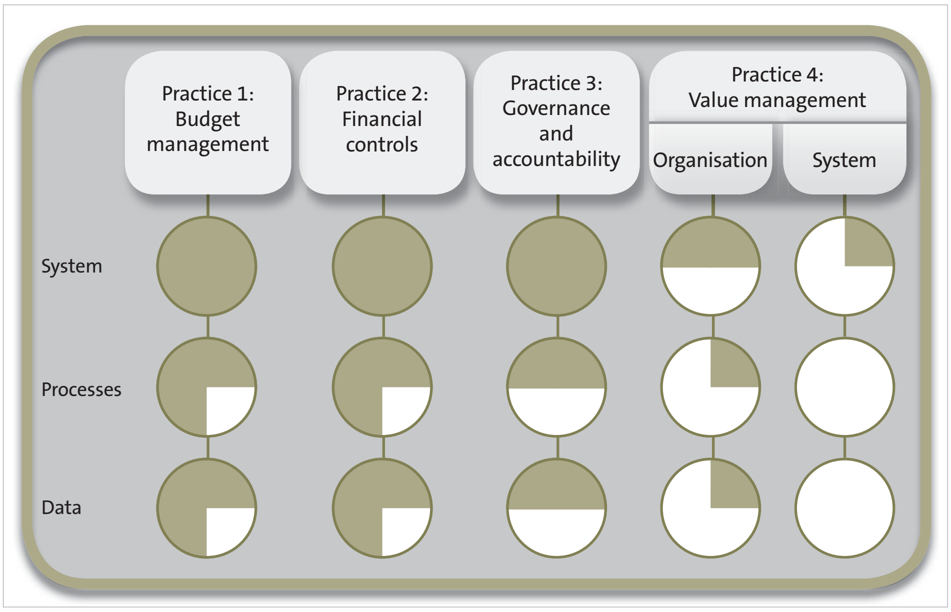
Systems, processes, and data

4.35 This section examines the "infrastructure" needed to manage finances within and throughout government.

4.36 The systems, processes, and data required to manage a public sector entity's budget and control its finances are generally sound. However, in general, the requirements for value management are not supported well. Often, planning and budgeting processes and accountabilities were weakly in line with, and separated from, the preparing and defining of strategy.

4.37 Ernst & Young's experience working with government organisations suggests that, in general, a lack of process and/or managers' initiative, rather than the systems' capabilities, is responsible for these weaknesses.

Figure 11
Stage of maturity – Systems, processes, and data



4.38 **Strengths of systems, processes, and data** are:

- Most public entities' information systems can support sound financial management.
- Often, sector and system outcome data is good.
- Budgeting and external reporting processes are robust.

4.39 **Limitations of systems, processes, and data** are:

- Few public entities seek to collect reliable data about how and where resources are used and the cost of the services delivered, meaning that VFM cannot be understood.
- Financial and non-financial output performance data is generally weak.
- Often systems are not used to their full capabilities.
- Planning and budgeting are not always in line with work on strategy.
- Scrutiny of investment and divestment is largely limited to capital expenditure.
- Procurement practices tend to be heavily focused on probity and compliance with process rather than the effectiveness, value, and purpose of the spending.
- In general, there are no (or cumbersome) processes to support the financial management of more than one public entity.

4.40 **Recent innovations** include:

- changes to improve the quality of capital investment decisions through the Treasury's Better Business Case process. These are a positive step in carrying out a more sophisticated analysis of costs and benefits of significant spending.

Part 5
Responsibility for financial management

5.1 In this Part, we discuss the role of public sector entities in supporting, co-ordinating, and aligning the financial management system throughout government.

Roles and responsibilities

5.2 Supporting the Government's decentralised structure requires an integrated financial management system in which many parts of central government must understand and prioritise the four practices of financial management in a coherent and aligned way.

5.3 The roles and responsibilities for financial management and financial performance in public sector entities are clear. The Public Finance Act 1989 states that the chief executive of a government department is responsible for the financial management and financial performance of the department. The State Sector Act 1988 made chief executives accountable to their Ministers for, among other things, financial management and the financial performance of their departments.

5.4 At the central agency level, the Treasury administers the Public Finance Act, has delegated regulatory powers, and can instruct chief executives to provide regular financial and performance information to Ministers, including the Minister of Finance. The Treasury is leading a review of the Public Finance Act aimed at improving the financial flexibility and long-term financial stewardship of government.

5.5 The State Services Commission administers the State Sector Act and appoints and employs the departmental chief executives, which includes assessing their performance regularly. The Commission is reviewing the State Sector Act with the aim of, among other things, broadening the powers of the Commissioner to a more strategic level focusing on agency, sector, and system-wide performance.

5.6 Despite the clarity of their individual roles, many chief executives and CFOs said they want clearer and more active leadership of financial management throughout government.

5.7 The Treasury, as the principal economic and financial adviser to the Government, is responsible for managing the financial affairs of the Crown and has a natural lead role and responsibility in promoting and sustaining a strong and consistent financial management system throughout government.

The role of the Treasury

5.8 The Treasury's strategic documents set out a wide range of functions and operating styles to support the financial management system, while working within it (see Figure 12).[4]

Figure 12
The Treasury's role and operating approach

The Treasury's role	The Treasury's operating approach
Monitoring and managing the financial affairs of the Government. Providing economic and fiscal policy advice. The main agency supporting ministers to balance priorities through the Budget process. Providing insight into how effective and efficient government entities are, and their actions. Ensuring that the State sector has robust institutions and incentives. Ensuring better-quality regulation. Improving the managing of risk throughout the Crown's balance sheet and providing robust advice on improving the performance of Crown assets. Ensuring that incentives are in place to drive performance in public entities. Focusing on the sectors where the government spends most, to ensure that it is consistent with long-term fiscal strategy. Integrating and improving budget frameworks and tools. Designing budget and financial management systems that create incentives for continuous improvements and support the Government's fiscal strategy.	A Navigator – shaping debates and being looked to by the Government, public and private sectors, and the wider community to help New Zealand navigate through challenging times, creating and maximising opportunities; An Expert – providing expert commentary and advice on economic, fiscal, public sector management and regulatory issues, as well as using and integrating the expertise of others; A Problem-Solver – working collaboratively with stakeholders and other government organisations to deliver innovative solutions to problems; and An Exemplar – leading with exemplary performance and exhibiting a culture of continually striving to improve in everything we do.

5.9 How the above are put into practice has implications for the priority of financial management within agencies and how well financial management functions as a system throughout the whole of government.

5.10 The Treasury should continue to prioritise its stewardship and leadership of financial management and on reconfiguring its role as the CFO of government.

4 Taken from the Treasury's 2010–2015 Statement of Intent, the Treasury's 2010/11 Annual Report, and Gabriel Makhlouf's "Welcome to the website of the Treasury".

5.11 The Chartered Institute of Public Finance and Accountancy states that "The CFO occupies a critical position in any organisation, holding the financial reins of the business and ensuring that resources are used wisely to secure positive results."[5]

5.12 To become the CFO of government, the Treasury needs to have:

- clarity about its role;
- systems and processes to carry out and manage this role;
- knowledge about agency, sector and whole of government performance; and
- capability and capacity to inform, advise, review, and intervene to improve financial management.

5 CIPFA (2010), *The role of the chief financial officer*.

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