

Treasury Board and Finance—Analyzing Performance

Summary

The *Results-Based Budgeting Act*¹ was recently enacted. It is directed at successful service delivery outcomes, program assessments and longer term, strategic prioritization. Public reporting by ministries on performance and results should supplement information in traditional financial statements and budgets. As part of meeting accountability responsibilities, information from the financial statements and budgets should be analyzed and incorporated into the ministries' reports on performance results.

Each year, ministries set out their goals in a business plan. Performance measures and targets are aligned with the goals. These three items serve several purposes. For the public, they identify matters the government deems important and establish a base for accountability. To those in government, the combination of goals, measures and targets direct planning, resource allocations and staff initiatives.

As an accountability mechanism, there is public reporting of the analysis of significant performance measure variances between current year actual results, the business plan targets for the measures and recent historical results. The framework for this reporting is presented in the *Government Accountability Act*,² *Ministry Business Plan Standards and Reference Guide*³ and *Ministry Annual Report Standards*.⁴

Ideally, information from the variance analysis is used in subsequent review, planning and operational decision making processes, such as those envisaged under the *Results-Based Budgeting Act*. Once variances have been critically examined and explained, the information and

learning from the analysis process should guide the next round of planning.

What we examined

Our audit objective was to assess the quality of performance measure variance analysis used by ministries in their business plan and annual report preparation processes.

Why it is important to Albertans

The analysis ministries perform to evaluate actual results against targets and prior years' results provides information to decision makers to determine whether desired outcomes were achieved, progress was made and value was received for money spent. It also helps assess what needs to change, how changes should be made and how to improve future plans.

What we found

Ministries take a wide variety of approaches towards their results analysis reporting, including the performance measures variance analysis component. The variety of approaches, and the associated processes, by itself is not problematic. The concerns, and hence our recommendations, are with the varying degrees of inconsistent interpretations of the current performance measure reporting requirements and non-compliance with certain of the performance measure reporting standards.

Overall, the ministry reporting commitments to Albertans for performance measures are only being partially met—a high percentage of significant performance measure variances are not being explained in ministry annual reports. The quality of performance analysis and reporting can be improved.

¹ SA 2012, C.R.-17.5

² RSA 2009, C.G.-7

³ Ministry of Treasury Board and Finance internal document

⁴ Ibid.

What needs to be done

Increasingly, governments are moving towards multi-faceted and integrated public reporting models that go beyond traditional budgets and historical cost financial statements. The challenges of good performance reporting are expected to grow. As the complexities of public reporting increase and new initiatives are introduced, it is important that the basics of performance assessment, such as variance analysis, be handled well and consistently across government.

Performance measures processes must be integrated into management systems. Government managers should show that they are using performance information in the management of their organizations. Public reporting on performance measures appears to be challenging for ministries, from selecting the measures through to reporting on actual results. To ensure balanced evaluation and follow-up, decision makers need to tolerate failure and recognize the effect of uncontrollable factors.

Setting challenging goals and targets carries the risk, even with the best effort, that some targets will not be met. As the Government of Alberta increases its focus on results, it is critical that ministry staff receive appropriate direction, training and support in the area of performance measurement.

We make our recommendations to the Department of Treasury Board and Finance because it manages the business plan and annual report standards for the Government of Alberta.

Audit scope

We examined a sample of six ministry annual reports for the year ended March 31, 2011, along with the three-year business plans (2010-2013) most recently associated with the 2011 annual reports. The sample set of ministries are representative of the overall breadth of performance measures, measurement tools and performance measure processes used by ministries.

Background

Variance analysis is a standard management tool used in performance assessment. The mandated reporting of this information contributes to public sector accountability. The steps of a variance analysis review process will generally include the quantitative identification of variances, usually expressed as a numeric amounts and percentage difference or change values. It is best practice for the quantitative variance information to be assessed qualitatively, developing the explanation for the variance from the target and from prior years' results. Management should consider the effect of its decisions, the operating environment and significant external factors. Even when targets are met or substantially met, it is useful to assess the factors contributing to that year's success.

Findings and recommendations

Improve ministry annual report processes

Background

Variance analysis should critically assess and interpret why the variance occurred, particularly if it is considered significant or material. Given the significant variance explanation requirements in the *Government Accountability Act*, senior management should be involved in final decisions as to the variances that have been assessed as significant and require public report explanations.

Quantitative variances may be classified as favourable or unfavourable when actual results are compared to targeted outcomes established in prior years. The quantitative values form the base for follow-up qualitative assessments, including any designations as significant variances that will require annual report commentary to explain reasons for each of these variances.

Recommendation:**10 RECOMMENDATION**

We recommend that the Department of Treasury Board and Finance work with ministries to improve annual report:

- preparation processes for identifying significant performance measure variances and developing explanations for these variances for reporting
- approval processes, including senior management sign-off of a summary of the year's performance measure variances and significant variance assessments

Criteria: the standards for our audit

Each ministry should have a process that, for each of its performance measures, identifies all variances between the current year actual result and the business plan target, and recent historical results. Analysis by ministry staff and management should follow this identification, including assessments identifying the significant variances. Explanations for the significant variances should be developed for reporting in the results analysis section of the ministry's annual report.

Our audit findings**Key findings**

The majority of ministry processes sampled are not identifying all performance measure variances and significant variances between

- current actual results and business plan targets
- current actual results and recent historical results

Each ministry is responsible for its own annual report preparation, approval and public release processes.

We reviewed annual reports and met with ministry staff involved with the performance measure aspects of planning and reporting. We reviewed ministry documentation for the Budget 2010

planning and target setting, as well as for the 2011 annual report preparation and approval processes.

Annual report preparation

Ministry employees generally used documents and emails from the prior year to guide their current year annual report preparation work. Procedures for retaining and managing performance measure documents and emails varied between ministries. Work plans were primarily focused on the timing of annual report preparation steps.

Performance measure working papers that ministries used to develop their business plans and annual reports generally did not show the numerical and percentage change amounts between current year's actual results, the business plan targets and recent historical results (i.e., the variances).

The performance measure working papers generally included a section with "materiality" or "significance" assessment as part of the heading. Statements in this section tended to be fairly general and limited, with a percentage of 5% (often) or 3% (sometimes) most frequently listed. Typically, management would also use judgement and consider factors such as percentage change, target met or not met, and change in year over year trends. A rationale for choosing one materiality/significance option over others, or otherwise supporting the percentage selection was usually not documented.

One ministry presented a complete and clear set of data identifying the variances for each of its measures. In addition to listing the annual report summary table amounts, its working papers listed the numerical and percentage change from comparing the current result to the target, immediate prior year result and an average of the last four prior years' results. These amounts were related to the materiality/significance factor used for each performance measure and a statement that the variance was assessed as insignificant or significant was documented. Where the variance was assessed as significant, analysis was drafted to explain and provide reasons why the current result differed from the comparator.

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This commentary formed the basis of the variance analysis narrative in the annual report.

Annual report approval

Fairly early on in the annual report drafting processes of the ministries we audited, the performance measure working papers details were “left behind,” and not revisited. Once drafted, the annual report document moved ahead on its own for revisions and approvals. Senior management approval of the annual report was for this document as a whole, without any detailed staff declaration or sign off that all specifics that should be in the annual report had been appropriately included.

Our analysis

In the absence of clearly defined sampled ministry processes to identify significant variances, we performed our own quantitative examination of the 2011 annual report performance measure statistics for the sample set of ministries. We identified approximately 100 performance measure components (individual measures, plus any subcategories with separate targets) in the six 2011 annual reports we examined.

We found that ministries did not explain a high percentage of significant variances. We found that 40% of the approximate 100 performance measures used by the ministries examined were potentially significant—explanations for 20% of these variance were in annual reports. At the less stringent 10% level of significance, the percentage of potentially significant variances dropped to 30% of the total number of measures—explanations for 25% of these variances were reported.

In the absence of significant variance analysis explanations, the commentary in ministries’ annual reports was a combination of:

- explanations of measure mechanics, repeating some of the required methodology write-ups that are usually in a separate section of the annual report
- general factors that might affect the measure’s results, without specifying the applicability (or non-applicability) of the general factors to the current year’s significant variance

- restatement of statistics in the standard performance measure summary table
- ministry program descriptions and activity listings, often without reference to any measures

In several cases where variance commentary was not in the annual report, there were some good variance analysis notes and information in the performance measure working papers that could have formed the basis for a suitable annual report explanation.

The variance analysis explanations did not make use of financial data (e.g., costs—base level or incremental/reduced amounts of funding, cost savings that could be linked to the difference explanation) in their results analysis commentary.

The annual report preparation processes of most ministries did not identify variance amounts and percentage change values for all measures. In the absence of identifying these variances, there is no informational basis on which to assess the significance of the differences.

Ministries effectively assessed a large percentage of potentially significant variances as insignificant by not following up with explanations in the annual report. There was no documentation of the qualitative considerations supporting the ultimate “insignificant, no annual report explanation required” assessments.

Operationally, management should monitor its performance measure trends and take action on a timely basis when it assesses performance results to be significantly different from current expectations. However, for some measures, processes only considered variance related issues when the annual report preparation process was well underway. Earlier identification and preliminary performance reviews may increase the likelihood of more timely operational decisions, as well as more complete reporting.

Two of the six ministries in the audit sample presented only three years of actual prior results—the immediate prior year, plus two years before. This differs from the five total years of actual results that the annual report standards specify.

In several cases management cited plans to discontinue the use of certain measures, providing this as a reason for not completing more detailed variance analysis work.

Overall, there were gaps in most ministries' senior management approval processes. These gaps were such that senior management in a large number of ministries may not appreciate that there are significant variance explanation requirements to be met in each year's annual report.

Measuring Up report

As part of this audit, we examined the processes for preparing and approving the *Measuring Up Progress Report on the Government of Alberta Business Plan 2010-2011 Annual Report*. This report includes broader, macro-level measures directed at high-level outcomes that are priorities to Albertans. It is prepared using information from ministries, professional survey firms and agencies such as Statistics Canada. The Measuring Up report processes will benefit from improved performance reporting by ministries.

Implications and risks if recommendation not implemented

In the absence of a thorough review of actual result variances from targets and recent historical results by ministry staff, it is possible that required follow-up will be limited or overlooked. Shortcomings or failures in variance analysis and related processes may result in:

- ministries not complying fully with legislated performance measure reporting and accountability declaration requirements
- incomplete or potentially misleading reporting to Albertans on ministry performance

Improve performance measure reporting guidance and standards

Background

The use of performance measures as a supplement, and ideally interrelated complement, to traditional financial statements is relatively new to the public sector, as well as to the private sector. Guidance and best practice alternatives in various aspects of public sector performance reporting continue to evolve.

Recommendation:

11 RECOMMENDATION

We recommend that the Department of Treasury Board and Finance improve its guidance for:

- performance measure target setting
- variance identification
- significant performance measure variance assessments and annual report explanation development
- preparing the results analysis section of ministry annual reports

The improved guidance should include updates to the ministries' business plan and annual report standards. These changes could be supported by training sessions and presenting samples of good practices on the inter-ministry website.

Criteria: the standards for our audit

The Department of Treasury Board and Finance should manage processes that provide clear, comprehensive guidance on setting targets in business plans and reporting results in annual reports. This guidance should be designed so that explanations of significant performance measure variances are reported, complete and reasonably consistent between ministries.

Our audit findings

Key findings

- Processes for target setting vary widely between ministries. Guidance in the business plan standards on setting performance measure targets is minimal.
- Reporting on significant performance measure variances is inconsistent between ministries. Guidance in the annual report standards on variance analysis is minimal.
- Annual report commentary on significant performance measure variances rarely makes use of related financial data.

The Department of Treasury Board and Finance coordinates and manages the business plan and annual report standards processes. It receives input from ministry representatives each year in advance of updating and releasing the standards for the following year. We met with Department staff regarding the process for managing these standards. In meeting with the audit sample ministry representatives, we obtained their comments on the standards and update processes.

Target setting

Ministries varied in their approaches to setting an initial target in a business plan, as well as in their reviews and updates of the performance measure target for each of the next two business plans. The majority of ministries we audited indicated that guidance for target setting in the *Ministry Business Plan Standards and Reference Guide* is limited.

Significant variances—assessments and report explanations

The majority of ministries indicated that guidance in the annual report standards for the identifying and reporting on significant performance measure variances is limited. In the absence of such guidance, ministries made their 2011 significance assessments in a variety of ways (and, as noted earlier, in many cases did not make such assessments). The significance assessment was not required prior to 2010 since, under the annual report standards at that time, the results for all measures were to be discussed. Starting with the 2010 annual reports, only measures with significant variances require results analysis commentary.

Integrating financial information

Staff involved with performance measure planning and reporting generally worked separately from the ministry's financial and managerial accounting groups. The use of financial accounting information in annual report variance analysis reporting was rare.

Implications and risks if recommendations not implemented

Performance reporting is an area of growing scrutiny and importance in the public sector. Assessment approaches and considerations used by the ministries should be consistent to support cross-government accumulations of data (e.g., in the annual *Measuring Up – Progress Report on the Government of Alberta Business Plan*) and performance analysis. Shortcomings in variance analysis and related processes:

- may result in non-compliance with legislated performance measure reporting requirements
- may result in or contribute to less than optimal ministry and/or ministries' resource allocation and related decisions
- may result in difficulties transitioning to various aspects of the government wide results-based budgeting initiative