QAO better practice guide: long-term financial planning

Quite often, clients in public sector entities do not have the time or resources to understand the long-term effects of their policy settings, and strategic and operational plans on their financial sustainability. This guide explains the value of a long-term financial plan, what it should entail, and what entities should consider when developing it.

Further details and examples can be found in our report on *Forecasting long-term sustainability of local government* (Report 2: 2016–17), which was tabled in parliament on 11 October 2016. The report can be found on our website at: www.qao.qld.gov.au/reports-resources/parliament

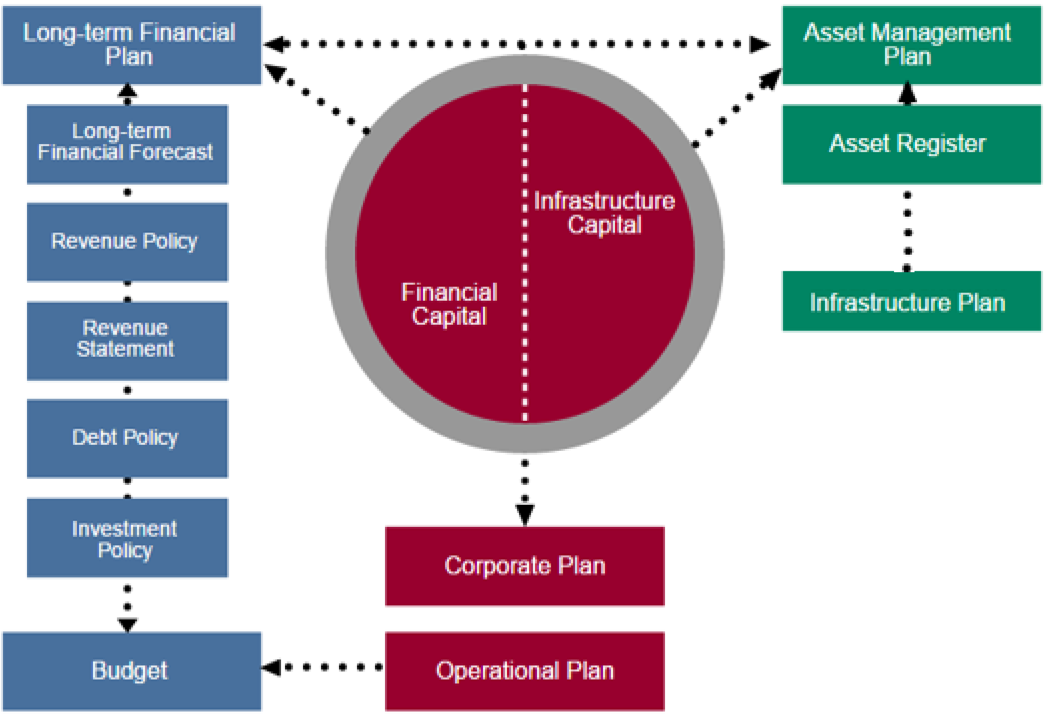
Why plan for the long-term?

Legislation requires some entities to prepare long-term financial plans; whereas for others, while not mandated, it is good practice.

The close coupling of operating revenues, asset spend, and debt means long-term financial planning must focus on an entity's ability to regularly achieve at least a break-even position (where revenue and expense are equal). If entities are to fund new infrastructure, invest in their operations, and manage long-term debt, they must plan to make regular operating surpluses.

Figure 1A explains how strategic and operational planning documents can underpin an entity's long-term financial sustainability. It also shows that financial plans need to align with corporate and asset management plans to demonstrate how the entity intends to remain financially stable.

Figure 1A
Good practice: planning documents to demonstrate financial sustainability



Source: Queensland Audit Office

What is a long-term financial plan?

A long-term financial plan describes an entity's financial strategy. It includes a long-term financial forecast and is consistent with other operational documents, such as a long-term asset management plan. 10 years is the minimum period a long-term plan and forecast should cover.

A long-term *asset management plan* includes forecast expenditure for renewing and upgrading assets, and should align with asset registers. It should explain how your entity will deliver infrastructure and investment over the long-term.

A long-term *financial forecast* summarises the 10-year projections for revenue, expenditure, assets, and liabilities. It allows you to calculate measures (ratios) of sustainability. Legislation requires some public sector entities to include this forecast in their annual budgets.

Figure 1B outlines the characteristics of a long-term financial plan.

Figure 1B
Characteristics of a long-term financial plan

Long-term financial plan

Executive summary

- Overview of financial objectives and key strategies
- Basis of preparation, sources of data, and key assumptions
- Policies that support the financial plan

Key financial information

- Summary financial data—income, expenditure (operating and capital), assets, and liabilities
- Statement of comprehensive income
- Statement of financial position
- Statement of cash flows
- Capital program
- Key parameters (such as revenue and cost drivers, employee numbers, and price drivers)

Key explanations

- Financial strategies and policies
- Key risks
- Measures of financial sustainability and target ranges
- Sensitivity analyses
- Major assumption or limitations

Better practice

- Concise and easily understood
- 10-year horizon
- Integrated with asset management plans
- Updated annually
- Publicly reported

Source: Queensland Audit Office Report 2: 2016–17

What do I need to consider?

Investment in time

A plan will not add value to decision-makers and stakeholders if it is not robust or sophisticated enough to respond to changing circumstances. Quality plans and forecasts need time and appropriately skilled staff to develop them. Do not simply 'roll forward' expenditure and revenue, and escalate using general price and cost indices. This business-as-usual approach 'locks in' existing policy settings without testing whether they remain realistic or viable.

Take the time to understand and select the appropriate inputs, where management intends to take the business, and how the entity will achieve their vision.

But the investment in time can translate to better long-term management of financial sustainability through improved decision support information, and the ability to respond earlier.

An appropriate forecasting model

Changing circumstances is an inherent risk in planning for the long-term. Changing revenue streams, uncertainty in grant funding, moving interest rates, and increases in wage and raw material costs are all difficult to forecast. A model can demonstrate the effect on an entity's long-term financial plan from changing variables.

Quality underlying data

Many public sector entities manage complex assets and provide goods or services for a fee. Public sector entities need good quality data and a clear financial strategy to set the parameters needed to produce accurate forecasts. Accurate asset condition data, remaining useful lives, and price indices in your local economy are important to ensure forecasting can be relied upon.

Entities that have poor quality data should immediately develop and implement a plan to improve it. Even forecasts underpinned by poor data, where limitations are acknowledged, will aid decision-makers.

Communication

A long-term financial plan is written to explain the financial strategy and forecasts. Accordingly, it needs to be written in plain language, have tailored explanations—not standardised definitions of financial metrics—and be relevant to those charged with governance and the entity's stakeholders, including the public. The entity will need to revise the plan if those charged with governance are unable to use it to aid their decision making and improve the business.

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