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Scenario Planning

PLOTTING A COURSE THROUGH AN UNCERTAIN WORLD

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What is the issue?

Uncertainty, volatility and unpredictability characterize the environment in which most organizations now operate.

Why is it important?

It challenges how an organization makes key decisions, which reinforces the need to develop and implement a robust decision making model.

What can be done?

Scenario planning provides a structured framework for evaluating the links between what is known today and what could happen tomorrow.

MANAGEMENT ACCOUNTING GUIDELINE

OVERVIEW

Introduction to the Concept

Imagine you are sitting at your desk. It's September 2007, the Dow Jones Industrial Average (DJIA) is close to 13,900; U.S. unemployment is 4.5%; oil is at \$45 a barrel; the U.S./Canadian dollar exchange rate is 0.95; and the U.K. economy is growing at a healthy 3% rate. You are in the middle of developing your organization's plans and budgets for 2008.

How likely is it that the assumptions in your 2008 plan will accurately forecast that one year from now (October 2008) the DJIA will be below 9,000; U.S. unemployment will have risen to 6.5% on its way to more than 10%; oil will rise to over \$140 per barrel before falling back to below \$40; the U.S./Canadian dollar exchange rate will rise to more than 1.25; and that the U.K. economy will shrink by 5%? Never mind the impact of terrorist bombs in Mumbai, a collapsing housing market in the U.S. and the U.K., a global H1N1 pandemic, and an almost total freeze on credit.

An aberration? Maybe. However, there is no doubt that volatility and uncertainty are here to stay, and managers are questioning the logic of basing strategies, plans and budgets on a single, static view of the future that is derived from an extrapolation of past performance.

Increasingly, managers are realizing that the past is not a good predictor of the future — hence the growing interest in tools such as rolling forecasts, dynamic budgeting, contingency planning, and scenario planning.

For professional accountants in business, a working knowledge of scenario planning can help to apply core accounting disciplines such as cost management, profitability analysis, risk management, and performance measurement, as well as forward-looking strategic and operational planning, budgeting, and forecasting.

Leading or participating in scenario planning programs:

- provides professional accountants in business with an opportunity to demonstrate real added value to their organizations,
- reinforces finance and accounting's role as a business partner, and
- is a significant addition to a professional accountant's skillset.

What is Scenario Planning?

Scenario planning provides a structured method for managers to evaluate alternative views of what may happen in the future as an aid to strategic, operational and financial planning. A scenario is a cohesive set of assumptions that describes a view of the future that is then used to develop a forecast or to test a strategy, plan or decision. Scenario planning is largely focused on answering three questions:

1. What could happen?
2. What would be the impact?
3. What are the implications for our organization?

For many organizations, scenario planning is now an integral part of their overall planning and risk management processes. As agility, flexibility and responsiveness have become prized strategic capabilities, scenario planning has become an important tool because it allows organizations to envision how their behaviour will change in response to different situations.

Scenario planning techniques are being used to help organizations better understand the implications of a broad range of decisions impacting business strategy, investment prioritization and operations. Of particular note to professional accountants in business is that many organizations are looking to integrate aspects of scenario planning into short-term management processes such as risk management, business case development, budgeting, forecasting and competitive analysis.

Why is Scenario Planning Relevant?

Uncertainty, volatility, and unpredictability have come to characterize the environment in which most organizations now operate. For many, the luxury of relying on detailed long-term plans or budgets predicated on a stable view of the future has long gone. The global economic crisis of 2008–2009 served as a powerful wake-up call: On the one hand, managers began to understand the futility of trying to plan future performance in great detail based on a single set of assumptions and, on the other, they began to understand the value of addressing risk and uncertainty in all aspects of the management process. Scenario planning can help by explicitly contemplating alternative views of the future.

Investors, boards of directors, regulators, and managers are all seeking greater insight into both the positive and the negative impact of risk on future performance. Although most companies have made good progress to improve the quality and availability of financial information (with the occasional push from regulators), leading companies are simultaneously upgrading the processes, measures, and tools they use to manage business risk. Risk identification, monitoring, and management are now integral parts of any effective performance management process.

Scenario planning is all about asking questions:

- What if our view of the future turns out to be wrong?
- What if the unexpected does actually happen?

Scenario planning provides a structured framework for evaluating the possible linkages between what is known today and what could happen tomorrow. It is not a precise science and there is no right answer.

The objective is to provide a framework for evaluating different courses of action. The answers to these questions are not certainties, and many financial professionals find the subjectivity and ambiguity embedded in scenarios unsettling. The future, by definition, is unknown. So rather than ignore it, embrace it!

Critics of scenario planning question the relative subjectivity of the approach and also its applicability to all but the largest organizations. However, many of these concerns are due to a failure to use the tool properly or engage the correct constituencies to ensure that:

- senior management actively sponsors the use of scenario planning,
- the scenarios have credibility, and
- most importantly, the results are effectively integrated into management decision-making processes.

How does Scenario Planning Ensure an Enterprise is Sustainable (RAISE)?

As the marketplace continues to evolve at a rapid pace, organizations are faced with the dilemma on how to be resilient, adapt and innovate in their quest not only to sustain a competitive advantage and meet customer/client needs but also to remain as a viable ongoing concern. A useful philosophy for ensuring successful adoption of the scenario planning process is CPA Canada's RAISE philosophy (whereby Resilient + Adaptive + Innovative = Sustainable Enterprises).

Given the relevance and value derived from leveraging the scenario planning program, the RAISE philosophy not only changes the way organizations effectively operate; but it also provides a repeatable and sustainable method for deriving ongoing value for an organization's customer/client base, while the organization reaps ongoing value in return.

At its core, the RAISE philosophy can help guide an organization (or enterprise) towards a unique customer-centric and competitive strategy that provides an ongoing sustainable edge. Scenario planning leverages these philosophy drivers by developing resiliency in the face of challenges within competitive customer environments, adapting to sudden market changes, and innovating in response to the ever-evolving market needs. When these drivers of success are combined and leveraged, the outcome is a highly sustainable enterprise. This concept is explored further in this [guideline](#).

How do Professional Accountants in Business Add Value?

Professional accountants (CPAs) with a sound knowledge of the scenario planning process play a critical role in promoting the RAISE philosophy by assisting an organization to realize the benefits described in this management accounting guideline series. Senior financial professionals are increasingly tasked with strategy and operational/tactical execution.

Like most management tools, the key is to use scenario planning in the right situations and ensure that the right parties are engaged in the process. Scenario planning is as much about the process an organization undertakes as it is about the results. The dialogue and debate that is inherent in effective scenario planning inevitably leads to the discovery of new insights about the interaction of different drivers of both the external and internal environment. The willingness to contemplate the impact of alternative future scenarios on strategies, plans and decisions equips managers to navigate through uncertain times with greater confidence and an increased awareness of the choices and options open to them.

A successful scenario planning program both draws on and sharpens the skills and expertise of professional accountants in business in several ways, in the following forms to ensure sustained value:

Enabling Value

- **Planning process:** Professional accountants supports the strategic planning process as management considers the financial implications of alternative strategies under different future scenarios.
- **Strategic management:** An understanding of scenario planning equips the professional accountants with tools that can help advance their careers into more senior finance or general management roles through a richer understanding of how to effectively manage in a volatile and uncertain world.

Creating Value

- **Financial planning:** Professional accountants understand the value of developing alternative financial plans and forecasts under different scenarios along with testing key assumptions and financial measures.
- **Conducting analysis:** Many organizations are integrating aspects of scenario planning into financial planning, budgeting and forecasting processes, and are looking to professional accountants in business to support in conducting rigorous and insightful analysis.



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This publication is one in a series on *Scenario Planning*. The entire series of [overview](#), [guideline](#) and [case study](#) are available on our [website](#). For additional information or for general inquiries, please contact us at mags@cpacanada.ca.

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