Best practices:
Using an integrated toolset to survive in a new era

Grant Thornton LLP

November 4, 2011

© Grant Thornton. All rights reserved.

Current fiscal environment
Same story, different day

- While more significant in scale and scope, the current fiscal situation is not that different than our normal planning environment:
  - Resources are always constrained—there is never enough to meet all demands or desires
  - Political decisions impacting government programs and operations are always possible
  - Need to scale government services against available resources and constituent performance requirements is always present
- What is unprecedented is the seemingly unrelenting demand for developing and pricing budget scenarios to meet both short- and long-term reduction targets

The current fiscal environment has shown the limits of our financial and operational planning and management tools and techniques

© Grant Thornton. All rights reserved.

Key systematic challenges

- Costs!
  - Health care
  - Retirement
  - Disability and welfare related
  - Critical infrastructure needs
  - Education
  - Corrections
- Outdated and inadequate revenue systems
- Myopia, tunnel vision, special interests and self-interest
- Expansion of government at all levels

© Grant Thornton. All rights reserved.

Alabama's budget

- Alabama has a total state debt of $60,412,502,000, when calculated by adding the total of outstanding official debt, pension and other post-employment benefits (OPEB) liabilities, Unemployment Trust Fund loans, and current budget gap.*

* State Budget Solution "Report reveals aggregate state debt exceed $4 trillion" October 24, 2011 via http://sunshinereview.org/index.php/Alabama_state_budget#cite_note-6

© Grant Thornton. All rights reserved.

We acknowledge that there's a problem and survey results say that we're dissatisfied and worried…what next?

- Strategy
- Operations
- Leadership

Leadership must come first, followed by a clear strategy

Operational improvement and financial stability can be orchestrated together or separately, as the situation warrants

© Grant Thornton. All rights reserved.

Strategy

© Grant Thornton. All rights reserved.

Strategy

- Core services

  Governmental units need to engage in a strategic assessment that includes a decision framework for prioritizing its activities. The first question to be answered is: What should be included in the government's service offering?

- Core competencies and priorities

  Having identified the strategic activities of the government unit, the next question that needs to be answered is: What are the government's core competencies? In other words, what activities does this government unit perform that are unique to the community, cannot be easily imitated or deliver value that is best in class?

© Grant Thornton. All rights reserved.

Tools

- Strategic planning
- Benchmarking
- Performance measurement
- Constituent management

© Grant Thornton. All rights reserved.

Strategic planning – what's the point?

- **Communicates vision to constituents:** Allows constituents to understand what our role is and what we are here to deliver
- **Forwarding thinking:** Plans for the current and future goals of a government. It's ambitious but bound in reality. For example, it articulates what it means to provide value, and how to get there.
- **Roadmap for success:** Provides a "map" to keep the government and the services it furnishes aligned with the needs of its constituents
- **Helps prioritize the allocation of resources**: There are lots of things that government is asked to do, but there are not enough resources for everything
- **Alignment for the organization:** Concerted strategic planning effort can link the overall state goals, objectives and measures to departmental plans down to employee performance plans.

© Grant Thornton. All rights reserved.

Strategic planning components

A strategic plan helps the organization take stock of its strengths and weaknesses, clarify the key needs of stakeholders, develop strategies for meeting those needs, and convert those strategies into action-oriented projects/initiatives that can be monitored and adjusted to ensure success.

Components of a Strategic Plan



Outcomes

A Strategic Plan that:

- Emphasizes longer term (1-5 years out) objectives
- Focuses on macro level
- Is specific—but not as detailed as tactical
- Considers multiple perspectives to be balanced
- Grows out of discussions with groups of stakeholders so that all are committed to its implementation

© Grant Thornton. All rights reserved.

Strategic Planning Best Practices

- Dedicate resources to the planning process – cannot be rushed
- Involve leadership and key stakeholders from the beginning
- Communicate throughout the effort, sharing both the process and the outcomes
- Only document what you can commit to, but be ambitious and forward-thinking
- Find a way to measure every goal
- Develop measures that provide actionable information
- Disseminate the plan in a one-page format
- Revisit your strategic plan every 2-3 years

© Grant Thornton. All rights reserved.

Other strategy tools

- **Benchmarking –** helps determine where peer organizations are, best practices in state government, and where you want to focus your own improvement efforts
- **Performance measurement** – a key part of any strategy is making sure it's working. Performance measures and defined targets help track progress and determine when an initiative is or isn't meeting its intended purpose.
- **Constituent management** – stay abreast of changing needs of the community you serve, and keep communications open to constantly respond to their needs and inform them of ongoing efforts to serve.

© Grant Thornton. All rights reserved.

Strategic planning case study
Pension Benefit Guarantee Corporation

- Developed IT Strategic Plan to help the organization determine how to use limited funds to meet expanding IT needs.
- After the plan was developed, IT divisions and individuals created their own performance plans to link to the broader IT plan.

© Grant Thornton. All rights reserved.

Operations

Operations

- Scope of service

  What are the fundamental tasks of the given program or service?

- Organizational design

  An organizational design that was crafted 20 years ago may no longer match the entity's scope and mission. Drawing from scope of service review, personnel organization can have an enormous impact on the economic efficiency of a governmental unit (form follows function). And, as form follows function, expense follows form: labor expenses are often among the largest component of any government budget.

- Process design

  Expense savings may be achieved by streamlining and consolidating processes.

© Grant Thornton. All rights reserved.

Tools

- Cost management
- Performance management
- Process reengineering
- Process improvement
- Managed competition
- Shared service delivery
- Outsourcing

© Grant Thornton. All rights reserved.

Cost management

: "...there is pressure on virtually all governments to cut costs and hold the line or even cut taxes. To do that in the best way, you have to develop good cost information. Otherwise you might just decide to cut services rather than figure out a way to deliver those services more efficiently."

Anne Kinney
Former Director of the Budget Office in Milwaukee

© Grant Thornton. All rights reserved.

Shifting the focus to target value

- Target value is the level of performance that a product or service must achieve in order to meet customer expectations
- Value itself is a function of performance (timeliness, accuracy, usefulness, quality) and cost to produce and or provide a service
- Thus Target Value is achieving the optimum balance of performance and cost

VALUE = Function (PERORMANCE, COST)

© Grant Thornton. All rights reserved.

Shifting the focus to target value

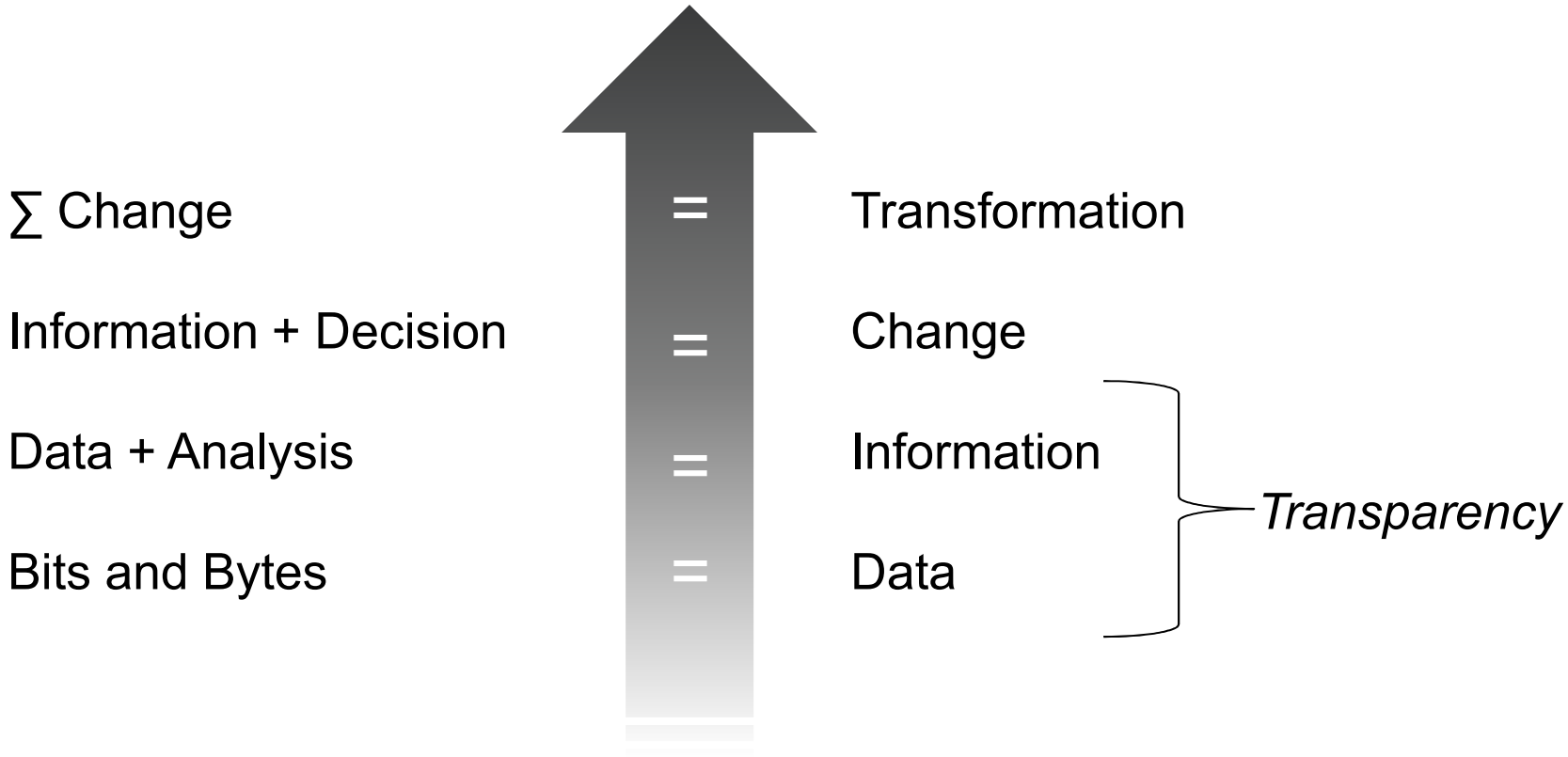
- Achieving a target value requires a sound knowledge of:
  - Components of value
  - Activities that contribute to components
  - Levels of resources consumed to hit the target

- Organization can get the right combination to optimize cost, improve performance and achieve target value by :
  - “Pulling the thread” on component of low value
  - Investing in components that enhance overall value

© Grant Thornton. All rights reserved.

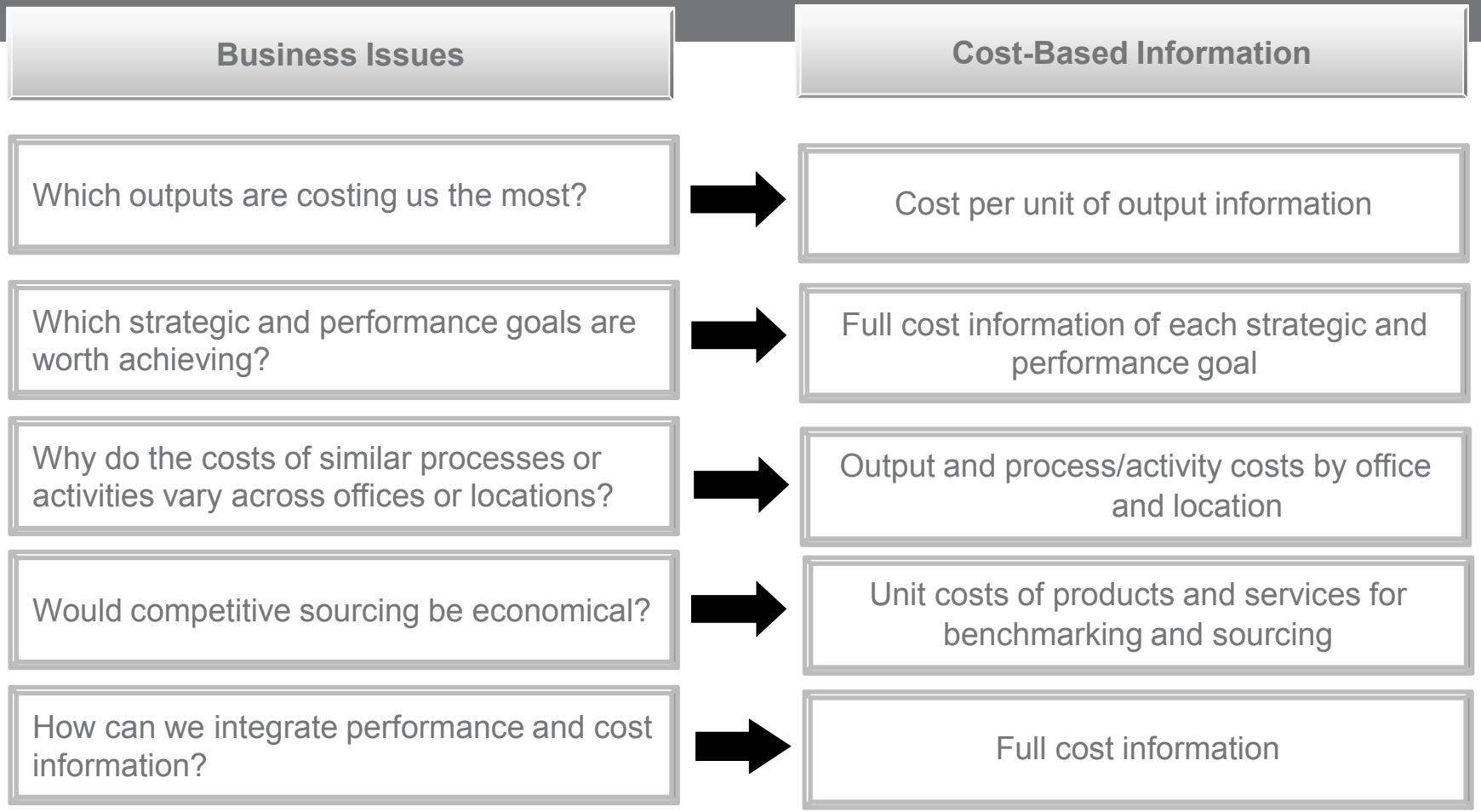
Data driven transformation

Cost and Performance Data + Energy = Transformation



© Grant Thornton. All rights reserved.

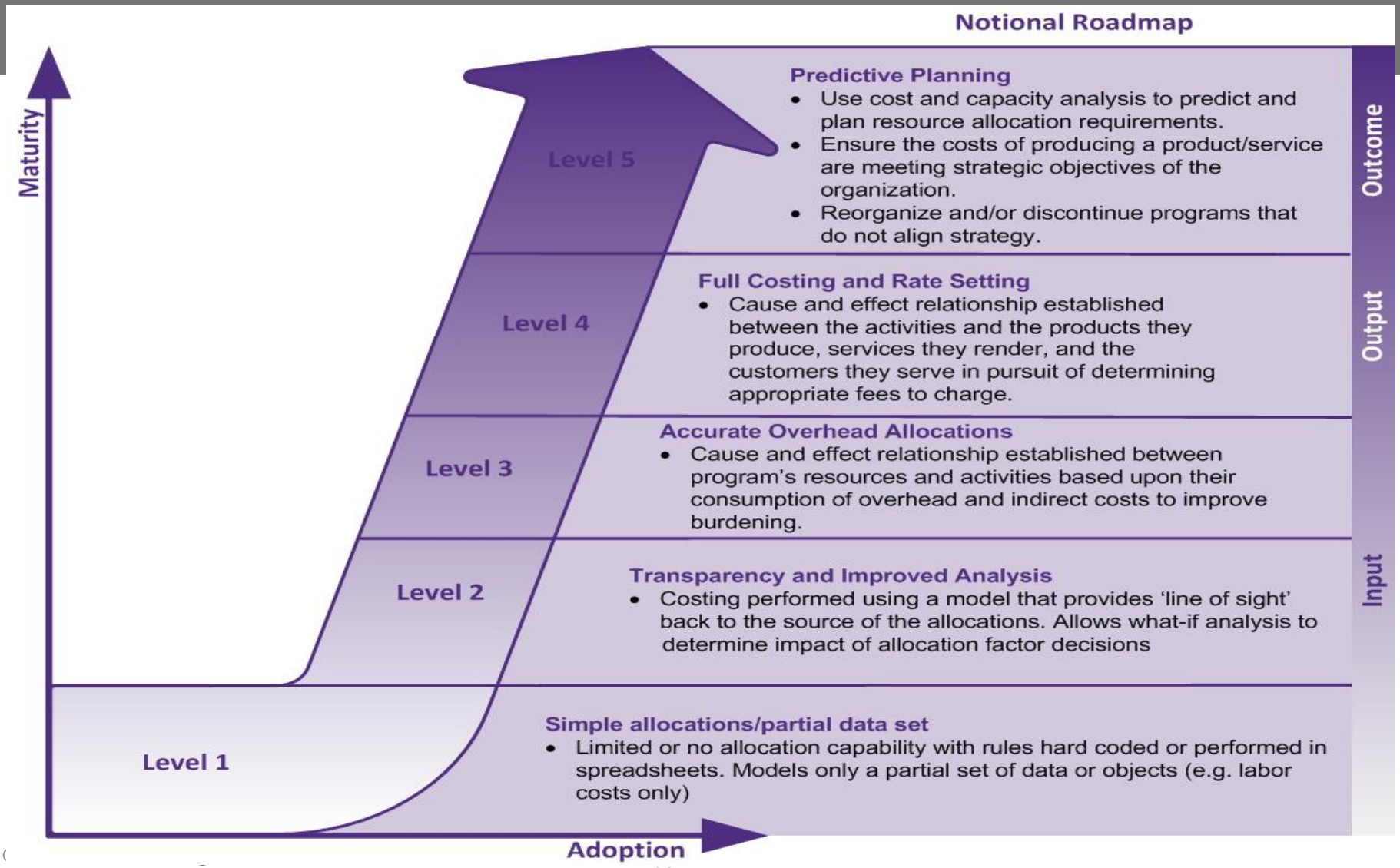
Aligning cost information to organizational performance



Cost Management can help answer key business questions.

© Grant Thornton. All rights reserved.

Grant Thornton's Cost Management Maturity Model



Costing methods

Process Costing:
A method that accumulates costs by individual processing divisions (or organization divisions that perform production processes). The output of a processing division either becomes the input of the next processing division or becomes a part of the end product.

Standard Costing:
Carefully predetermined or expected costs that can be applied to activities, services, or products on a per unit basis. As work is being done, actual costs incurred are compared with standard costs for various tasks or activities to reveal variances.

Capacity Costing:
A method to determine the costs of unused capacity. Most Government organizations appreciate the value of understanding unused capacity costs, but lack the accounting capability to provide reliable capacity measures. It is often difficult to separate operational capacity and readiness capacity.

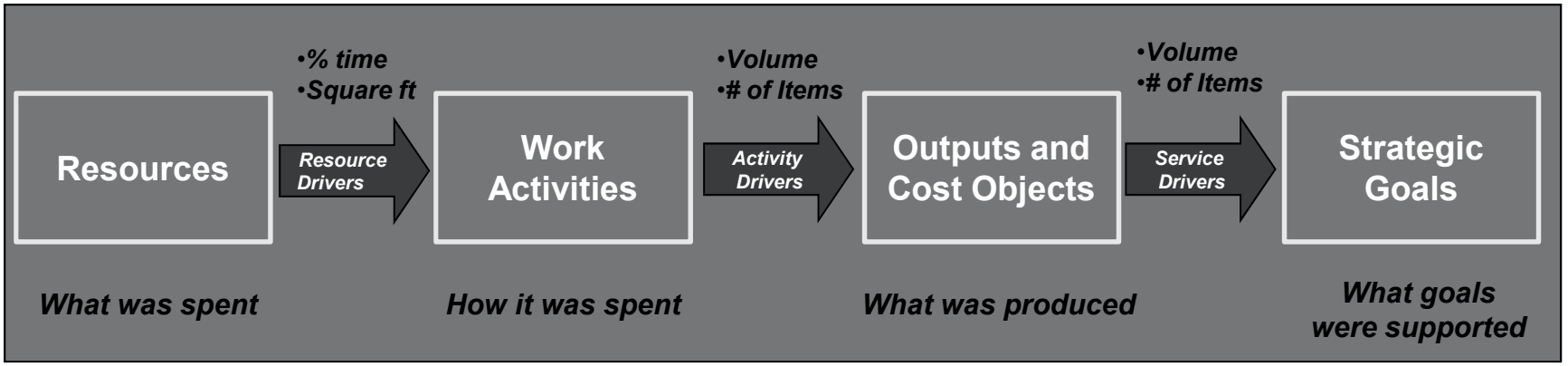
Project Costing:
A method that accumulates and assigns costs to discrete projects. Each project has a number or code to accumulate costs. Resources spent are identified with the project code. Costs are traced to individual projects to the extent economically feasible. Costs that cannot be directly traced are assigned to projects either on a cause-and-effect basis or allocation basis.

Activity Based Costing:
A method that operates on a simple concept of two-stage assignment of costs: Resources are consumed by activities, which are further consumed by products/services (cost objects) to satisfy customer demands. The methodology establishes the link between inputs (resources) and outputs (cost objects), often utilizing cause-and-effect relationships (activities) to assign costs.

© Grant Thornton. All rights reserved.

Activity-based costing methodology

Successful Cost Accounting Efforts use Activity-Based Costing (ABC) Methodology to Drive Value



- Measures the full cost and performance of work activities and outputs
- Provides insight into the relationship between inputs (resources) and outputs by quantifying the work performed (activities)
- Recognizes the cause-and-effect relationship between the costs of outputs and the activities performed by an organization
- Costs can also be aggregated by cost objects

© Grant Thornton. All rights reserved.

Traditional vs. activity-based view of cost

Example: Forestry In-Kind Assessment

Traditional View

Labor	$6,000,000
Equipment	$4,500,000
Materials	$340,000
Contract Services	$650,000
Facilities	$1,120,000
Supplies	$250,000
	$12,860,000

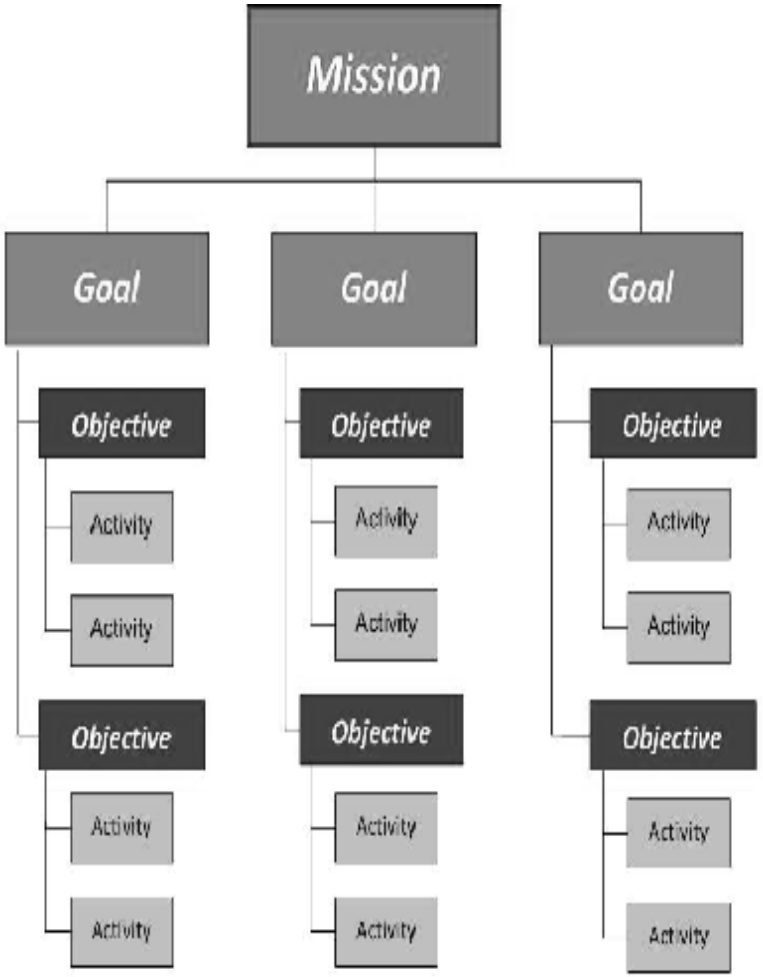
Activity View

Process In-Kind Forms from Land Owners	$3,740,000
Perform Physical Assessment of Private Land	$3,360,000
Perform Physical Assessment of Public Property	$1,160,000
Perform Walkthrough of Physical Inventory	$760,000
Perform Assessment of Property Damage	$1,410,000
Perform Audit of In-Kind form Submission	$1,030,000
Provide Customer Service Assistance to Land Owners	$510,000
Provide Human Resource Mgmt	$380,000
Manage Recruiting and Staffing	$510,000
	$12,860,00

Which view provides more insight into the use of organizational resources and how priorities can be established?

© Grant Thornton. All rights reserved.

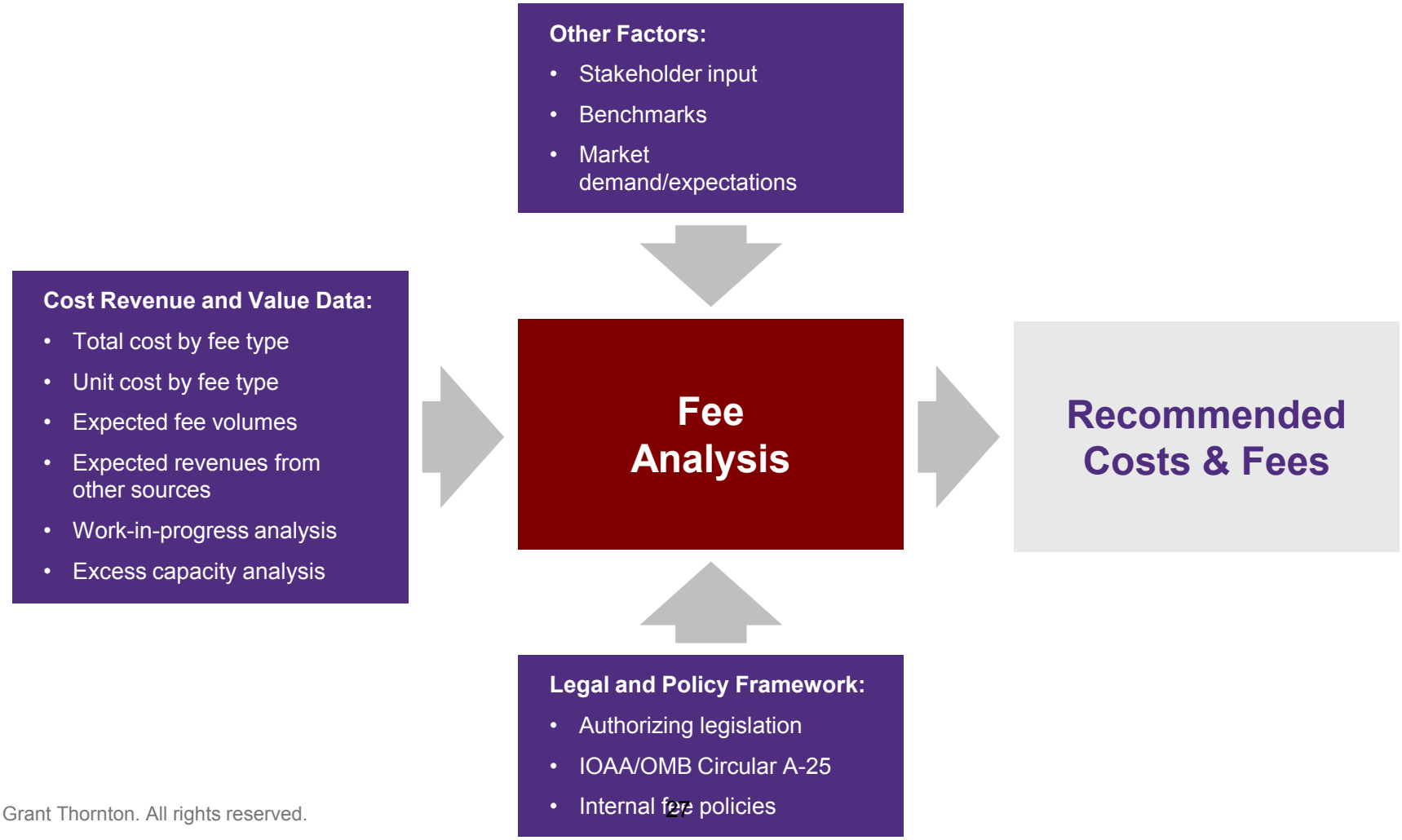
Alignment of resources to strategic goals



© Grant Thornton. All rights reserved.

- Tools assess strategic relationship and hierarchy of agency mission, goals, objectives, and work activities
- This “line of sight” between the operation tasks across different program and support offices answer questions such as:
  - Are there activities of limited value in supporting an objective? If so, can resources be reassigned to more productive work?
  - What would be the impact on achieving strategic goals if that activity were not performed?
  - Where do we have opportunities consolidate similar support and in some cases mission functions and remove duplication and achieve economies of scale?

Rigorous and defensible costing & fee setting



© Grant Thornton. All rights reserved.

Case study

U.S. Patent and Trademark Office

- U.S. Patent and Trademark Office's (USPTO) is $2B fully fee-funded Performance-based Organization
- USPTO's Activity-Based Information (ABI) program was launched in 1997 to support the development of financial statements.
- ABI has evolved from a compliance exercise to an integral part of USPTO's management decision making process.
- An independent review assessed ABI program as a "best practice" in federal government. Today ABI program supports:
  - Fee Setting
  - Chargeback of IT and other administrative costs
  - Performance management and
  - Process Improvement
  - Budget formulation and resource planning
  - Financial statements
- The ABI program is playing a significant role in transforming USPTO's fee structure and funding mechanism in preparation of the impending fee setting legislation

© Grant Thornton. All rights reserved.

Case study

Department of Health and Human Services

- Health and Human Service's working capital fund (WCF) provides funding to over 70 administrative, technical, and operational shared services to Federal, state, local, and tribal customers with over $1B in annual sales
- HHS developed ABC cost model to:
  - Determine cost of performing all activities and providing all products and services for pilot organizations
  - Assess the accuracy of current prices and overhead rates for products and services to determine if they fully recover associated costs
  - Establish a standardized and transparent methodology, in accordance with Federal standards, for developing and monitoring these prices and overhead rates
  - Provide stronger justification for pricing decisions through increased visibility into costs recovered in each rate charged to customers
  - Provide the ability to scale productive capacity and associated overhead based on demand forecasts and budgeting decisions
  - Provide what-if capabilities to support scenario analysis
- HHS is using the cost model to support ongoing budget reduction efforts and to re-price certain services and rates that were determined to be inaccurate

© Grant Thornton. All rights reserved.

So what does this mean?

- Better analytics are needed to set priorities for the future of doing less with less
- Process of getting there needs to be more collaborate & transparent
- Activity-based analytics & cost management provide the framework for "success"

© Grant Thornton. All rights reserved.

Leadership

© Grant Thornton. All rights reserved.

Leadership

- **Turnaround coach**

  A turnaround adviser can rise above political considerations and stay focused on strategy, operations and finance.

- **Pain sharing**

  For success, all stakeholders must buy in to the need for the restructuring. They must see themselves as part of the problem, and part of the solution.

© Grant Thornton. All rights reserved.

Tools

- Communications
- Effective labor management

© Grant Thornton. All rights reserved.

Communications – why do they matter?

- Helps constituents understand challenges facing governments
- Can be used to advance a cause or prove a need
- Shows constituents you care and are working to improve – even if diminishing resources make improvement difficult
- Two-way communications help you understand what your constituents need
- Strong, positive internal communications are the foundation of external communications

© Grant Thornton. All rights reserved.

Benefits of a communication plan

- Provides you with a documented strategy for engaging constituents
- Helps catalogue existing communications vehicles and identify needs for new ways of messaging
- Determines procedures for creating/distributing messaging surrounding sensitive activities
- Helps ensure that your constituents have multiple ways to *hear* you, but also multiple ways to *talk back.*

© Grant Thornton. All rights reserved.

Best practices for communication

- **Honesty** – Be upfront and transparent about WHAT is happening, WHY it is happening, WHEN it is happening and HOW it will impact users.
- **Two-Way** – Always include contract information so the recipient can follow up with questions or comments. Capture, incorporate, and respond to audience feedback whenever possible.
- **Clarity** – Use the language of the targeted audience rather than jargon. Use as few words as possible to communicate your message.
- **Consistency** – Make repeat messages consistent through all delivery channels, for all recipients, and from all senders.
- **Courteous and Positive** – Use positive, respectful language.
- **Tailored** – Tailor communications for each event and audience. Managers should get only a high-level summary of any changes, while users should receive a detailed summary of required actions.
- **Targeted –** Do not send large group emails unless it is truly necessary. Target communications only to those who are affected by the subject of the communication, signaling to stakeholders that any communication they do receive is important and relevant.
- **Multiple Channels** – Use multiple channels appropriate to the message and audience.
- **Quality Assurance** – Ensure that communications are grammatically correct and include all necessary information.
- **Approval** – Where necessary, receive approval for communication
- **Evaluate** – Determine the strengths and weaknesses of communications on a regular basis, and modify as necessary.
- **Frequency** – Communicate information to affected stakeholders as soon as a change is identified and at frequent intervals afterwards.

© Grant Thornton. All rights reserved.

Conclusion: There is a problem, but…

© Grant Thornton. All rights reserved.

Conclusion: There is a problem, but there's also an answer and it's taking off the green eye shades, using an integrated toolset and being proactive

- CFO's **role** in risk is more than financial
- Do not bury **risk office** within the entity
- **All** executives are responsible for risk management
- Predictive & statistical analytics are ripe for **OCFO** use
- CFOs must lead in **selling** the value of analytics
- Today's setting requires doing **less with less**
- **Analytics** help deal with cuts & prioritize risks
- Time is right to show **true CFO value**
- Financial reporting model needs change to **add more value**
- **Debt** requires better institutional control

© Grant Thornton. All rights reserved.

Questions?



© Grant Thornton. All rights reserved.