

Returning to balance
Pragmatic solutions and
untapped opportunities
for governments in deficit



An age of austerity

These are challenging times for governments at all levels.

While public sector leaders are always working within limited budgets, the current economic situation is placing extraordinary pressure on government finances.

Left with massive deficits due to stimulus spending and weakened tax revenue, governments require pragmatic solutions to improve their cost structure and must explore untapped opportunities to increase revenue, decrease costs, and optimize public assets.

To preserve confidence in the future stability of public finances, it's very important that Canadian governments, federal and provincial, now make commitments to the reduction or the elimination of that discretionary spending at some point in the future.

David Dodge
Governor, Bank of Canada, 2001-2008

The challenge of our times

Consider the numbers

According to government estimates, the federal and provincial governments are projecting a combined \$83.2 billion budget deficit for 2010-11, the equivalent of almost \$2,500 for every Canadian. Decisive action is required to prevent the largest inter-generational transfer of debt in Canadian history. There is now both a need and opportunity for governments to apply bold thinking and make fundamental changes to how government is organized and operates.

Why do governments need to act?

The budget problem facing many governments is structural in nature and won't be fully addressed by an economic recovery. During the latter half of the last decade as income tax revenue grew by 30%, governments seized the opportunity to introduce new programs and to lower taxes, including the GST and corporate/personal income taxes. In 2009, the situation reversed itself, with expenditures continuing to grow by 2% even as income tax revenues contracted by 8%.

What's different about this time?

Governments have been in deficit before, most notably in the 1980s and early 1990s. What makes this time different? Quite frankly, the depth of the recession, the fragility of the recovery, and the need for continued stimulus spending put governments in a difficult position, and created conditions unlike those of recent recessions. Added to this is the manufacturing collapse in Ontario, which has contributed to an epic shift in the equalization program, with the province drawing equalization payments for the first time in the program's history.

The current state of finances also limits the options available to today's leaders. Governments will not be able to download services and costs to lower levels as was the trend in the 1990s.

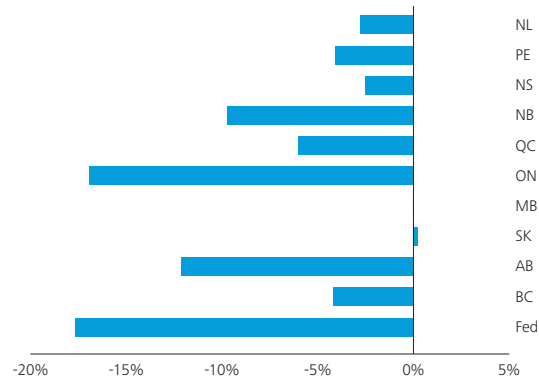
Pragmatic solutions

Traditional tools such as across-the-board cuts, public service hiring freezes and wage freezes are available but insufficient. Governments are facing true structural change in the areas of revenues, expenditures, and assets. They require a more thoughtful approach to alter their cost structures through an integrated program of fundamental change.

Untapped opportunities

The challenge for today's leaders is to identify the untapped opportunities available to improve revenues, contain costs and optimize the value of public assets.

Forecasted budget balances as a % of forecasted expenditures
Based on budget 2010 government estimates



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Managing public revenues

Focusing on recovery is less painful

To increase the amount of revenue taken in through taxes, fees, and other sources, government can grow the economy, expand or increase tax rates and user fees, or decrease the amount of uncollected revenues that are owed to government. The latter is largely an untapped opportunity. Deloitte research has estimated that Canada loses an average of \$19.7 billion in annual revenue due to a number of factors including uncollected fees and taxes, write-offs, or bad debt. Improvements can be realized by liquidating outstanding accounts receivable balances, and managing additions to the accounts receivable process through improvements to the collections processes and underlying technologies. This is money owed to governments.

Preventing this “revenue leakage” by improving the collection of tax and non-tax revenue can generate significant returns to help address revenue shortfalls, minimizing or eliminating the pain of increasing tax rates and user fees.

Increasing revenues through premium service to citizens

While maintaining the principle of equitable service to all citizens, governments can increase their revenues through selected premium services to citizens. Take, for example, ServiceOntario’s premium service for birth and marriage certificates. For an additional fee, these certificates can be delivered within five business days, instead of the typical 15 days.

Keeping pace with citizen expectations and behaviours

Inflexible information systems have made it challenging for governments to meet growing citizen expectations and demand for automated revenue collection services. This inflexibility constricts the flow of revenues, impedes governments’ ability to integrate collection systems, and will persist in the post-recession era.

It is also important to structure user fees and related taxes to reflect citizen choices and changing behaviours. For example, as vehicles become more fuel efficient and more of them appear on the road system, governments may need to consider introducing road pricing to reflect actual usage and to offset reductions in gasoline tax collections.

Revenue management transformation

A recent revenue management transformation project for a provincial government streamlined operations and increased cash collections, resulting in:

- Over \$160 million in incremental revenues collected in first 36 months without any capital investment.
- 10% improvement in overall collection rate.
- 13% increase in revenue realization.
- Cost to collect reduced by 57%.
- Increased visibility into accounts receivable and improved financial controls.

Source: Research conducted by Deloitte

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Containing costs

A thoughtful approach to cost management

Cutting costs seems like the most logical way for governments to address a deficit. However, governments must be careful when deciding where to make the cuts. Governments need to develop cost reduction strategies aligned with their needs. Across-the-board budget cuts are not sustainable and can actually hinder the delivery of services. Before deciding where to cut, governments must examine what can be cut. They need to look at the addressable spend within their budgets. Once governments figure out what “percentage of the pie” they are looking at, then they can look at mission-related costs and non-mission-related costs. Mission-related costs are those that directly relate to the objectives of the organization. Any expenditure that is not related to the priorities or objectives of the organization is a non-mission-related cost and is a potential candidate for cuts. Untapped opportunities also exist for governments to adopt lean practices and to reduce payments through data analytics.

The benefits of lean. In the past decade, “lean” techniques have become a prominent approach in the pursuit of process efficiency and cost reduction. Lean is in part a set of best practice analytical techniques for driving operational innovation. It focuses on matching delivery to the citizens’ needs through continuous process improvement and can empower frontline staff to eliminate waste and improve the customer delivery chain in terms of cost, quality and time.¹

Processing transactions for citizens

Lean techniques have been applied to various public sector processes including the handling of tax returns, welfare benefit claims, and license plate processing. As a private sector comparison, the same techniques are used to process mortgage applications and handle securities.

In one UK public sector agency, implementing an EU Directive, the application of lean techniques reduced the need for new staff from 250 to 30. This was achieved by removing unnecessary steps from the process, as well as finding easier ways of meeting the requirements.

Source: *In the Hot Seat: Reducing Costs in Public Sector Organizations in An Age of Austerity*, Deloitte Research, 2010, p.7

Harness the value of your data. Data analytics offer the potential to examine large quantities of raw data to identify trends and isolate instances of over-payment or fraud. Public sector organizations can use data analytics to review their transfers to recipients to reduce costs by eliminating inappropriate payments.

Misalignment equals opportunity. Do all your programs support your strategic priorities? All programs have merits, but in times of restraint programs must be measured against the mandate and objectives of government. If a program is not aligned to government objectives, it should not be delivered. If programs are not continually monitored and aligned with strategic objectives, they will continue to consume resources that could be better allocated elsewhere.

Are your programs performing? Are your programs achieving their objectives cost effectively? Once governments determine the right mix of programs, they can focus on their performance and how best to deliver them. Are the programs meeting their objectives and delivering the value expected from them? Are there different government models or alternate service delivery models to deliver these programs more efficiently? Are you spending unnecessary resources on mitigating low-impact risks that are unlikely to occur?

Re-visit your service delivery model. Are your programs structured and governed in the most efficient and effective manner? Cost savings may be realized by streamlining the network of service delivery. Is it possible to eliminate layers in the network? Sometimes organizations focus on reducing headcount to realize cost savings but this may actually damage organizational effectiveness in the long run. A longer term strategy requires looking at how people are organized (as opposed to how many people there are). Substantial and sustainable cost reduction can be realized by transforming the service delivery model by either reducing layers in the network or eliminating duplication of tasks.

Focus on where you spend. A majority of government spending is generally concentrated on a small number of departments, programs or functions. These key areas offer the best opportunity for governments to address their cost reduction challenges successfully.

¹ *In the Hot Seat: Reducing Costs in Public Sector Organizations in An Age of Austerity*, Deloitte Research, 2010, p.5

Optimizing public assets

Maximizing the value of Crown assets for citizens

There has been much discussion lately about selling Crown assets to offset the deficit. Asset sales can be viable options, but they should be considered within the context of the long-term alignment of the asset with public policy objectives. Three key questions should be asked in reviewing Crown assets for public value.

What is the public interest being served by this Crown asset? Governments long ago decided to create the asset in question to satisfy a public need. The question today is whether that public interest still exists and to the same degree.

Can the public interest be served through some alternative means? Given the expertise in a variety of fields that can be found within government, private business, and the not-for-profit sector, consideration should be given to whether the continuing public need can be served through an alternative means. Partnerships with senior and local orders of government should be explored, as should partnerships with the private and not-for-profit sectors.

If the government retains the Crown asset, what extra value can be captured for citizens? Can the Crown asset move to a self-sustaining model, reducing its reliance on the public purse? Can administrative services be streamlined to reduce costs? If the Crown asset pays a dividend to the government every year, can the dividend be increased?

It's not an all-or-nothing proposition. A review of Crown assets does not necessarily lead to privatization. Alternatives to selling government properties and facilities could include selling a portion of the assets, increasing their use through better property management, implementing shared back-office services, or requiring Crown corporations to improve performance and become less reliant on public appropriations. The key point here is that Crown assets should be reviewed to ensure they continue to provide maximum public value.

Ontario's asset review

In late 2009, the Province of Ontario announced that it had engaged outside organizations to conduct a review of Crown corporations involved in electricity, gaming, and liquor valued at between \$50 and \$60 billion. The province considered pooling these Crown assets into a mega-agency and offering a partial public share offering, netting up to \$15 billion for the provincial treasury. Although the government ultimately decided not to sell these Crown assets, the process provided a valuation of these assets and identified several go-forward actions that the government is considering to maximize their value for Ontario taxpayers.

Source: *With demise of Supercorp, search for windfall stymied*, The Globe and Mail, July 13, 2010

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Returning to balance

Governments can use these tough economic times to recalibrate their spending and revenues – this is what it takes to return to balance. Consider the following opportunities to manage within a deficit:

Review transactional performance and data to uncover opportunity

Identifying over-payments and potential revenue leakage and determining their root causes through improved data analytics will allow governments to put processes and system controls in place to reduce payments and increase collections into the future.

Explore how resources are expended and get lean

Determining where and how the organization is spending its resources can identify opportunities to eliminate waste and reallocate resources to priority programs. This information can also be used to identify opportunities to increase efficiency and reduce duplication or overlap.

Evaluate and eliminate programs that are no longer relevant

Using a sunset model on programs will allow for ongoing monitoring of the program's relevance to the organization's mission. Furthermore, an organization that is structured around its programs, rather than its functional capabilities, may benefit from increased efficiencies.

Examine the strategic value of assets

Assessing whether assets are aligned with the organization's long-term objectives can help determine their strategic value. Those assets with long-term value should be assessed for opportunities to increase their efficiency. Those that are not of strategic value should be candidates for potential disposition or sale.

Apply bold thinking

Most challenges create opportunities, and the major challenges governments face today offer untapped opportunities to apply bold thinking and fundamentally change the future cost structure of government.

Next steps for governments in an age of austerity

To meet this fiscal challenge, governments should get started with the following:

1 Get organized

Appoint a champion to lead the initiative and assemble a core team that understands the organization and the change imperative.

2 Be pragmatic

Set aggressive objectives and goals for the initiative, assess the realistic strengths and gaps in your internal capacity, and hire and retain credible expertise to help you execute and deliver.

3 Get started

Design and launch the process to identify potential opportunities for detailed review.

4 Communicate

Engage and be prepared to listen to the right stakeholders to build support for the initiative and overcome road blocks to success.

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Discover the Deloitte difference

To learn more about how Deloitte's public sector professionals can help, please contact

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