Result-driven budgeting models for Luxembourg institutions

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In the face of growing requests in the variety of services to citizens, getting allocated budgets and keeping them under financial control during their delivery become a priority for the Government of the Grand Duchy of Luxembourg and the Chamber of Deputies. They are invited to adapt the way of managing and monitoring the budget through integrated processes and new dimensions of budget allocation, applicable for different types of institutions: national, municipalities and para-public organizations.

Inspired by the OECD recommendations and EU Stability & Growth pact (i.e. regulation n° 1466/97 and 1467/97, originated in the Maastricht treaty), as well as by the European Member States (i.e. the United Kingdom in 1988, the Netherlands in 1994) pioneers in its application, the result-driven budgeting model aims at reinforcing the performance of the services funding in relation with assigned objectives. The challenges emerging from the last global financial crisis and from the new economy have increased the focus on budget controls and expenditure reductions, and transformed the citizens' expectations in terms of quality of services. It becomes clear that traditional budgeting processes no longer effectively serve the business objectives within public organizations.

Elected representatives and management staff do not have to look far in a typical public organization to find representatives of the Government, Chamber of Deputies or municipalities and state bodies who see little value in their current budgeting activities. While from a finance perspective, improving the budgeting process regularly figures on the agenda of the Head of Finance, significant change is rare in practice as inadequate management culture and limited standard technology capabilities are inhibitors of budgeting effectiveness.

In the effort to understand the reason for much of this frustration and why so little progress or changes have been made, we take the opportunity of this article to present Deloitte's view on the new budgeting model which does not have to be a source of pain and dissatisfaction, but more a source of effectiveness and efficiency.

The current budgetary principles in a few words

In Luxembourg, the administration of state property and the management of public finance are under the responsibility of the executive bodies. However, the Constitution reserves an important role to the Chamber of Deputies in the intervention and control of the legislature, and in the annual budget vote. The budget is established as an annual law and in accordance with the rules prescribed in the legislative procedure. Once voted, the Government is authorized to make the budget a reality by collecting revenue and incurring expenses during the legislative year.

The budget process includes three main construction phases:

- A debate on the fiscal stance during the government's presentation on the state of the nation, in the first half of each year
- A debate on the financial and budgetary policy during the review and the project's voting law concerning the budget of revenue and expenditure
- A discussion on the review of the Act approving the general accounts of the State

Constitutional provision stipulates that each year the budget and the general account of the State must be submitted to the Chamber of Deputies (incl. all operations of receipt and expenditure), for review, approbation and regular controls. It also stipulates that no budget can be allocated outside of those subjects, and the fiscal credits can only be used for fixed expenses covered by the budget authority.

For the sake of foresight, the Minister of Budget has a right of inspection in respect of the financial and budgetary management in all Luxembourg administrations, supported by the Inspection Générale des Finances present at all stages of the financial life of the State. This specialized body of the Ministry of Finance plays several important roles:

- An active role in the development and finalization of the budget, in particular through financial programming and economic and social funding objectives
- A controlling role for projects and proposals that could have an impact on public finances. It exercises controls and checks for compliance with the general policy of the Government, coming even before the commitment of expenditure
- A monitoring role with the implementation of projects and proposals which have been notified, the multiannual programs approved by the Government, as well as a control of their operational execution from a budget perspective
- A supervisory role to ensure that budget commitments issued by authorizing officers are registered and introduced into the budgetary accounts, providing exhaustive all-year information, and furthermore complete each stage of budget implementation

The *Trésorerie de l'Etat*, acting as the "budgetary banker", covers the following activities: payments, cash collection & management, and general & budgetary accounting. The main resources can be categorized as follow as:

- Collection of taxes and duties entrusted to Tax Administrations, respectively the Administration des Contributions Directes, de l'Enregistrement & Domaines and des Douanes & Accises
- Revenues from the state-owned companies and holdings
- Operations of public services and toll

When normal and recurring resources of the State are insufficient to meet extraordinary expenses, particularly for the execution of large-scale public works (i.e. railways, roads, canals, large buildings), the Government proposes to contract long-term borrowing that are submitted for approval of the Chamber of Deputies prior to finalizing contracting agreements. Alternatively, without resorting to borrowing, the Government can still raise funds through the issuance of Treasury bills in the short term, to cover current expenditure for which the State does not have sufficient liquidity.

Objectives, implementation and culture as foundation of the new model

Be clear about the purpose of result-driven budgeting

The first step is to address the question of what the purpose and objectives are for achieving budgetary reform through a result-driven budgeting process in Luxembourg institutions, competing effectively in the new economy with increasingly volatile revenue, and breaking free of the old budgeting mentality. This means applying guiding principles to ensure a balanced budget between income and expenditure, in particular by defining an appropriate:

- Structural balance: eliminating cyclical effects on the budget
- Sustainable balance: considering mid-term budgetary commitments
- Guaranteed balance: ignoring the mid-term non-guaranteed revenues

It also requires all efforts focusing on building a new foundation for sustainable improvement with more budgetary process responsiveness; identifying the people most capable of taking responsibility for decisions and accepting accountability for results within their domains; respecting budget allowance, and operating with cost savings and greater efficiency to achieve operational excellence.

Once that has been achieved, it is important to standardize terminology, definitions, and documentation of the new budgetary model.

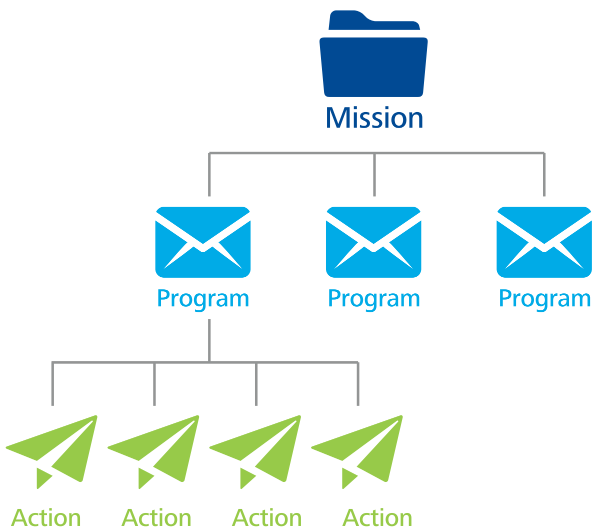
By setting-up a common language and instructions, it is easier to achieve better adherence to budgetary changes by stakeholders. As illustrated in the chart below, the result-driven budgeting process invites institutions' representatives to familiarize themselves with evolving concepts and terminology.

Integrated budget processing
The process gives visibility in the sequence of execution of budget process steps

- **Budget preparation:** entry – supplement – redistribution – transfer
- **Budget execution:** reservation – commitment – blocking – invoicing – payment
- **Budget closing:** month-end – year-end – financial reporting

Budget Preparation				
Centralized Budget Preparation	Decentralized Budget Preparation	Budget Maintenance		
Budget Execution				
Procure-to-Pay	Accounts Payable	Accounts Receivable	Project Accounting	Travel Management
Public Sector Accounting				
Cash Management	General Ledger	Cost Accounting	Asset Management	
Budget Closing & Financial Reporting				
Period-end closing	Year-end closing	Budgeting & Financial reports		
Grant Management for Grantee				
Grant Management for Grantee				

New dimensions for budget allocation
Beyond the existing budget allocation, the budgetary reform creates the opportunity to allocate budget through the angle of missions, broken down into programs and actions that will lead to the delivery of services engaged.



Source: Illustration of the LOLF (loi organique relative à la loi de Finance) applied by the French Institutions

These new dimensions of the budgeting process consist of:

- *Mission:* gather main political engagements initiated and defined by the Government, and its budget is voted by mission. It is managed and monitored at ministry or at inter-ministry levels, and comprises of several programs. The Chamber of Deputies has the necessary authority to reallocate budget to programs within the mission
- *Program (endowment):* define the operational budget within a predefined framework in which political engagements will apply. It is the application level of parliamentary delegation with documented credits, and is placed under the Ministry's responsibility and reflects a coherent and consistent set of actions
- *Actions:* provide detailed allocation of credits by type of revenue and expenditure (i.e., investments, overheads, and salaries) and by destination (i.e., actions, services, and activities). It indicates the breakdown of program details, and operations to make expected results a reality

The second step is to agree on what needs to be measured by relevant performance indicators, for which the institutions need to understand how their resource allocation impacts the achievement of objectives. They also need to define clear boundaries for decisions regarding the allocation of scarce resources in support of their short- and mid-term plans, and not just for monitoring financials. To achieve the strategic goals, the impact of real performance drivers must be monitored, and these boundaries, assumptions, and targets need to be integrated into and tracked in a budgeting flow to validate the decision-making process, especially in light of changes to key assumptions about the operating environment of missions and programs.

Executing the objectives of the institutions

Traditional budgeting activities often result from budgeting being undertaken in isolation of the institution's strategic objectives and priorities. A lack of alignment with budgeting activities increases the likelihood of decisions being made that detract from an organization's mid- and long-term goals. If a budget incorporates objectives and priorities, in particular from a mission and program perspective, it guides decision-makers with more visibility on activities to ensure the achievement of results in the targeted budgetary framework.

The main characteristics covered by the result-driven budgeting model are:

- **Multi-annual strategy:** increase visibility on the funding of the national/local institutions and activities
- **Transparency:** make the supervisory role of Members of Parliament more effective in the budget allocation and control of expenditure
- **Effectiveness:** increase autonomy and responsibility of key stakeholders within institutions and reinforce the sense of budget-oriented results

The budgeting strategy should set expectations for:

- **Luxembourg Government—Chamber of Deputies:** improve visibility on budget consumption, and resource allocation to missions and programs
- **Inspection Générale des Finances, Court of Audit and Internal Control Bodies:** ensure means and accurate view on budget flows, executed operations and compliance with regulations and internal procedures
- **Citizens:** provide better understanding and efficiency of tax revenue usage to deliver services that fit their needs
- **Civil servants:** clarify objectives, increase responsibility, and quantify resource availability

Without a clear strategy and expectations, staff, functions, and business units risk pursuing their own self-interests. Moreover, a culture could be created where executives and teams from different parts of the organization pull against each other rather than all pulling in the same direction.

Without alignment with the objectives, the adoption of a shared understanding of what is important to the organization becomes challenging. That tends to generate confusion, unnecessary repetition, lost time, a loss of ownership and reduced added-value. A well-aligned and result-driven budgeting process translates the business and service objectives into a simple story about an organization's role and the role that each party needs to play internally and in close collaboration with other national or local institutions.

Successful change rooted in culture

This new model is a key component of how i) information is generated and processed, ii) decisions are made, iii) how responses are formulated to guide institutions representatives, and iv) of the impact on the current and future performance. The process involved is closely linked to other financial (i.e., accounts payable) and non-financial (i.e., contract & purchasing) processes. They involve and connect many people and functions across the entire institution. The rules that regulate the new budgeting process are deeply embedded in organizational culture and there can often be a "this is the way we do things here" mindset. Change not only requires processes to be reengineered, but also a cultural shift to take place within all executive and staff communities. It is not just about making finance processes more efficient and effective; rather it is a case of making the institution as a whole more effective and responsive. The success of any initiative to improve budgeting processes is rooted in the culture and behavior of the whole organization. Culture is the key to unlocking the potential of budgeting: institutions can invest in the best technology, define clear roles and responsibilities, integrate their budgets with organization strategy, and refine their internal processes; however, if behaviors are wrong, particularly those of leaders, then the effectiveness of result-driven budgeting will remain limited.

It is the application level of parliamentary delegation with documented credits, and is placed under the ministry's responsibility and reflects a coherent and consistent set of actions

Gathering information and engaging executives on one hand and delivering clear, rapid decisions on the other can only be achieved where there is clarity on organisational roles and responsibilities

Reinventing budgeting process

Process discipline and improvement

Process improvement and discipline are key characteristics of successful result-driven budgeting model application within the institutions. From a mission/program perspective, they are invited to apply the same scrutiny to budgeting processes as for an operational application of political mandates, in close integration with other operational processes. While other organizations complete the traditional budgeting processes, struggle to explain the variances, and protect their targets, leading public organizations actively track and manage budget accuracy, including possible external influencing factors that might require budget adjustments. The main objective is to reduce uncertainty and keep the focus on results. Additional budgeting accuracy in mission/program allocation enables organizations to continuously anticipate gaps and highlight the need for corrective decisions.

The result is greater transparency with a more responsive and adaptive organization better able to:

- Identify and exploit opportunities from political or internal initiatives
- Fit budget objectives, missions, and programs to targeted results
- Identify and manage issues and risks
- Respond to changing circumstances in a moving and uncertain context
- Consistently outperform the initial objectives
- Increase long-term value for the Luxembourg government, municipalities, and citizens
- Define key indicators for performance measurement before/after mission execution

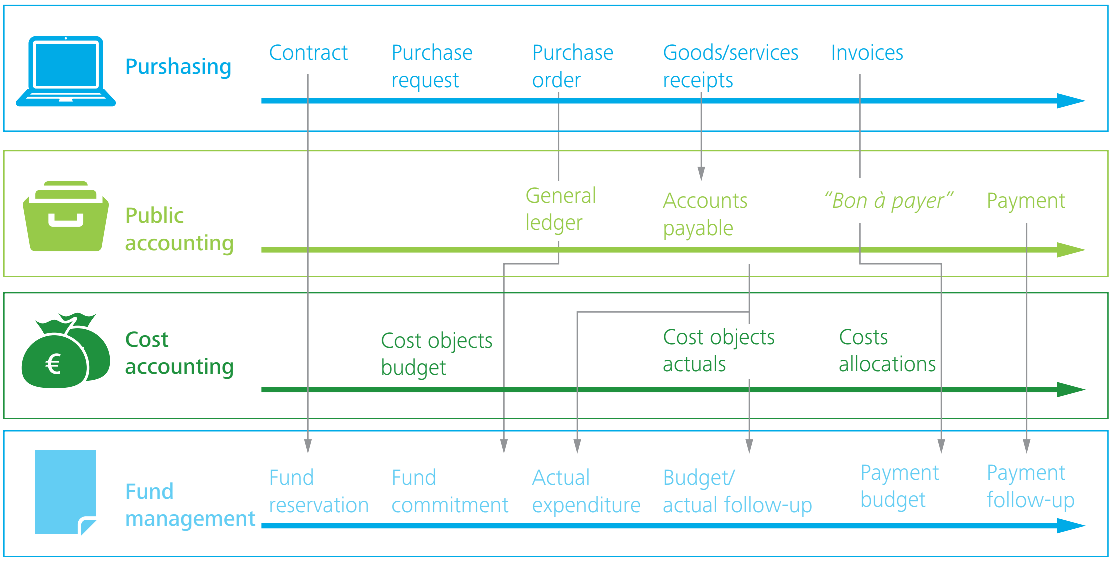
Focus on drivers not details

The specifics of an effective result-driven budgeting model vary from one institution to another, but the principles remain the same. Targets tied to strategy and objectives should frame the new budgeting process, set clear expectations and operations to be performed. There should be much less detail and more focus on drivers that have a material impact on mission/program results. The budget should be explicitly separated from target setting while earmarked funds should match main expenditures and revenue volatility in the institution's activity horizon and the time it takes for decisions to impact results

The importance of the end-to-end integration

Just as result-driven budgeting process should be integrated across government bodies, through processes (i.e., purchasing), divisions (i.e., administration), and functions (i.e., cost accounting). It should also be integrated across different planning horizons: long-term strategy provides a framework for medium-term planning and resource allocation (i.e., fund reservation). In turn, these assumptions are expected to be reflected in shorter-term operational activity budgeting (i.e. fund commitment, cost object budget).

In reality, institutions struggle with integrating these processes as they operate at different frequencies, levels of granularity, and often with different owners. Many of them entirely miss the point of planning and leap directly to budgeting. The end-to-end purchasing process, as illustrated below, shows the integration with cost accounting and fund management, both main components of the result-driven budgeting process beside the traditional processes.



Organizations that fail to link result-driven budgeting activities end-to-end, run the risk of creating confusion, misalignment and loss of business visibility on objectives achievement. Failure to ensure that operational and financial budgeting are aligned and missions/programs are shared and properly funded can lead to a "stop/go" approach to decision-making.

Clarifying decision-making responsibilities

The importance of a clear operating model

It is not uncommon for decision-making to stall during the budgeting process, as executives are often asked to make or accept mission/program plans regardless of whether they can control the outcome. Second-guessing takes place at each level of the organization, between government and municipalities, and between division and operating unit. Where the traditional hierarchical organization has given way to a highly matrix-based model, the lines of decision-making and control are blurred even further. Central functions are often responsible for managing key business operations that impact the organizational hierarchy, yet the precise nature and scope of that responsibility are not entirely clear for missions/programs. An efficient and effective budgeting process, in particular from a mission/program perspective, provides visibility on who is responsible for making what decisions.

Once made, these decisions should not be second-guessed. Executives have the right to challenge and test decisions but changes should be made by agreement, and decision-makers should then be fully accountable for the outcomes and delivery of their commitments. This will require a significant cultural shift as second-guessing, "adding value", and imposing a top-down "stretch" or "challenge" have become second nature in the budgeting process. Failure to involve the right stakeholders can result in plans that are not only strategically and operationally misaligned, but which also suffer from a lack of credibility. Budgeting processes that receive too much input become unwieldy and prohibitively expensive. Gathering information and engaging executives on the one hand, delivering clear, rapid decisions on the other, can only be achieved where there is clarity on organizational roles and responsibilities.

Make decision-makers fully accountable

Public institutions can do much to improve clarity over where responsibility for each decision area sits in the organization. The challenge is to first understand the kind of needs, issues and stakes, then to agree on their assignment and whom exactly has the right to make which decisions through the new result-driven model. In high-performing organizations, decision-makers will be fully accountable for the mission/program outcomes of their decision. In many cases the obstacle of culture will need to be tackled at the outset and in many organizations, there is an ingrained resistance to sitting down, asking for practice changes and impacts on roles, responsibilities, and hand-offs across the new budgeting model. Executives are often reluctant to recognize that there is an issue and then to invest the time required as its importance is not recognized. To achieve this difficult balance, leaders must make it clear who the right participants are and in what role. From there, the central role and that of the operating units must be defined accordingly. The role of the Finance department must also be clear, facilitating and advising other parts of the organization through the budgeting process, but letting them be owned by the department leaders, mission managers and decision-makers.

Exploiting the most recent technologies

A benefit for all types of institution

Today new technology platforms such as those provided by IBM, Oracle, or SAP improve the speed, reliability, and transparency of the budgeting process. While spreadsheets have their place as powerful personal productivity tools, implementing these result-driven budgeting platforms allows organizations to plan and budget on a much more collaborative and reliable basis. They allow information to be collected, aggregated, reported, and analyzed far more quickly than it is possible with spreadsheets alone. They also provide the capability to model different scenarios and the potential impact of variations in revenues and expenditures, currency fluctuations, and other variables. Sophisticated business intelligence solutions are now available for crunching large volumes of data (i.e. big data) to identify correlations between disparate data sets and provide predictive analysis that supports budgeting.

Crucially, this allows organizations to be more responsive through a better and timelier understanding of the potential impact of external factors (ex. evolution of needs and markets, political decisions) and internal constraints (ex. information accessibility and processing) on performance. As such, any investment program needs to be taken beyond a request from the Government. In national and local institutions, the Heads of Finance are invited to collaborate closely with organization leaders to develop a clear understanding of the true extent to which performance is impacted by existing issues with the budgeting process, and potential improvements that investment in technology can drive as part of a broader program of change.

Getting more controls and transparency

These systems also provide greater control (i.e., versioning, availability controls) and accuracy that could prove very valuable for the Inspection Générale des Finances, the Court of Audit, and Internal Control Bodies at each institution. Manual data re-entry and opaque and complex spreadsheets are a notorious source of mistakes. Solutions using purpose-built technology and properly engineered interfaces can significantly reduce the possibility of system error as well as automating and articulating the budgeting process with other main processes within the organization (i.e., earmarked funds, expenditure & revenue cycles by department or program).

The final key benefit is transparency, particularly in complex, interdependent, and yet siloed institutions. Result-driven budgeting is vital to managing and steering these organizations and as such, it is important to have visibility and rapid access to this data across the institutions as well as assumptions that underpin them. Workflow, auditability, and traceability capabilities provide transparency to monitor and manage the completion and submission process. This is simply not possible with a dispersed and fragmented spreadsheet solution.

Conclusion

The process of result-driven budgeting should sit right at the heart of the State of Luxembourg. Understanding the steps to get there is critical to ensuring the Luxembourg State stays on course with the challenges of the new economy, with agility and effectiveness in a fast-moving environment. Many public organizations still struggle to derive real value from their current budgeting activities due to unclear, ill-defined and unwieldy processes, lack of ownership by decision-makers—who are disconnected from the institution's services and more often entirely miss the point—and limited technology capabilities.

Addressing process and technology issues alone will certainly deliver incremental improvements in efficiency, integration and effectiveness. However, it is clear that any program aiming to deliver significant change and real and lasting value needs to recognize that these processes affect a significant number of people, perhaps as many as 30-40 percent, right across an organization. Cultural inertia acts as one of the biggest barrier to change.

Finance people like detail but data is not the same as insight. Process immaturity and the prevalence of a culture of financial details combine to create an inefficient system that provides access to too much information but little insight. More detail does not necessarily mean better decisions. The right insights that are easily accessible at the right time will drive improved decision-making.

The departments of Finance cannot afford to tackle this as merely a finance initiative. Achieving true change requires the involvement of executives, mission managers, and decision-makers from across the entire organization. In order to bring about change, managers need help in adopting a coherent and disciplined approach to planning such implementation and execution.

The public organization as a whole needs to be committed to seeing it through. What, then, is the best way to move forward? Deloitte believes the first step is to engage the executive team in a full, frank, and open assessment about the current issues and challenges (ex. operational, technical, staffing) presented by the existing processes and behaviors. In the second step, developing the ownership, commitment to transformation of the budgeting process, and commitment to change are paramount.