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Financial performance  
management

Transforming public  
sector budgeting  
and management



### Financial performance management: transforming public sector budgeting and management

State and local governments are contending with a confluence of issues as the American economy continues to recover from the 2008 financial crisis. While tax revenues remain under pressure, taxpayers are demanding increased investment in infrastructure, schools, and social programs.



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Financial performance management is the vision of a strategic, organization-wide budget, built from the ground up through interdepartmental collaboration, and achieving full transparency to taxpayers and other stakeholders.

States and municipalities also face uncertainty over federal funding as the makeup of the U.S. Congress shifts, and tough decisions loom regarding Medicaid expansion and the future of public sector pensions. Along with greater demand for quality services, government organizations are under increasing pressure to improve transparency, including demonstration of links between strategy, resource allocation and results.

Many states are improving the quality of their reports and making them available electronically. And, some are working to follow higher federal budgeting standards established by the Government Performance and Results Modernization Act of 2010 (GPRAMA). While states that can provide proof of performance are better positioned to obtain future federal funding, migrating to the standards is a huge leap from meeting the requirements of the original Government Performance and Results Act (GPRA) passed in 1993.

Many jurisdictions are ill-equipped to meet today's challenges. Gartner estimates that up to 80 percent of budget officers, especially in smaller government jurisdictions, still rely primarily on spreadsheets and homegrown systems to support analysis, forecasting and budget preparation.<sup>1</sup> Along with slowing down the budgeting process, these conditions heighten the risk of errors.

These factors suggest the need for a more comprehensive approach to budgeting and performance management – a migration from basic financial planning to financial performance management (FPM). This paper discusses how an FPM approach can help state and local government meet 21<sup>st</sup> century challenges.

1. "Critical Capabilities for Government Budget Planning Products" by Gartner (G00214312) September 7, 2011

### What is FPM?

FPM is a framework to increase the delivered value for a given taxpayer dollar. FPM goes beyond budget planning to incorporate performance management and outsourcing, strategy management, financial consolidation, and financial and management reporting and disclosure. It is the vision of a strategic, organization-wide budget, built from the ground up through interdepartmental collaboration, and achieving full transparency to taxpayers and other stakeholders.

FPM is an ambitious undertaking that requires fundamental changes to traditional state budgeting paradigms – far more than just deploying a new software application. FPM can challenge even the most sophisticated state finance organizations because no single “formula for success” exists. Each state needs to assess its current environment, reengineer affected processes, redesign the finance organization, and implement new (or adapt existing) supporting technology. As such, FPM requires an intricately woven combination of process design, organizational change management, technological partnership, and public-private insight.

### Process design – it’s imperative to reengineer budgeting from end to end

“Premature optimization is the root of all evil.”

Donald Knuth, renowned computer scientist<sup>2</sup>

A primary impediment in state budgeting transformation efforts is the inability to document, optimize, and ultimately automate the *entire* budgeting process. Instead, Knuth’s “premature optimization” often occurs – documenting a portion of the process and then attempting to optimize and automate only that portion. Across the breadth of a transformation effort undertaken in such bite-size pieces, technological stratification, and stage obsolescence can occur, impeding achievement of desired results. Additionally, vendor creep, which can be attributed to opportunistic vendors attempting to increase the scope of a project and their associated revenues, can result from a portioned approach.



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Today, the budgeting process needs to be addressed in its entirety, from forecast and analysis modeling through publishing, scorecarding, dashboarding, and reporting and data management.

2. Structured Programming with go to Statements, ACM Computing Surveys, Vol 6, No. 4, Dec. 1974

Effective end-to-end government budget process design takes into account not only the funding levels required to provide for key social programs, but the changes necessary under a variety of different revenue production scenarios. Lack of budgeting flexibility during the financial crisis forced states to attain significant cost savings from public assistance and higher education, precisely the programs that needed bolstering to smooth the path to economic recovery.

Process design in public sector budgeting involves multiple change factors in a single transformation program. Historically, government entities have used simple budgeting techniques and timelines – planning by line item and program, and focusing on operating expenditure categories, usually over a single year – an approach that lacks the fiscal agility demanded of state and local governments.

Today, the budgeting process should be addressed in its entirety, from forecast and analysis modeling through publishing, scorecarding, dashboarding, and reporting and data management. Process redesign takes into account a broad spectrum of budgeting techniques and the need to manage data inflows and outflows.

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States often shortchange internal and external communications relating to the transformation, as well as compressing employee and citizen training and user acceptance testing. Compression cuts costs. This lack of attention to change management often has a direct impact on user adoption, which can significantly restrict the achievement of transformation goals and ROI.

Moreover, outcome-based budgeting is more involved than traditional budgeting, which often requires little more than tweaking the previous year's budget. Lawmakers should understand what outcomes their citizens really want and make educated guesses about how much and where to spend.

Another challenge is demonstrating a reasonable connection between actions and outcomes. Whether enhancing child welfare, reducing prison recidivism, or protecting citizens from terrorism, today's public policy issues are often too complex for individual agencies to tackle on their own. Achieving these and other important societal outcomes requires the participation of multiple agencies across, up and down levels of government, as well as involvement from businesses and nonprofits. A broad process design addresses the issue of shared outcomes and helps equip decision-makers to identify and measure each agency's contribution to the desired outcome.

#### **Organizational change management – transformation fails without user adoption**

“Culture eats strategy for breakfast.”

Peter Drucker, renowned management consultant<sup>3</sup>

Performance-based budgeting is more than spreadsheets, scenarios, department codes, and flowchart arrows. It is collaboration among professionals in a defined organizational culture who share the goal of serving taxpayer needs at the lowest possible cost.

As Drucker pithily suggests, dismissing the importance of culture can be the first step toward wasting an enormous time and fiscal resources on a strategy blind to organizational realities. The challenges that states encounter in implementing budget process transformation often point back to one critical misstep – not bringing budget data managers, financial and accounting professionals, project management experts, and information technology personnel together with process professionals to redesign the budgeting system from inception to delivery of return on investment (ROI).

3. The Daily Drucker: 366 Days of Insight and Motivation for Getting the Right Things Done – October 26, 2004, by Peter F. Drucker

Making matters worse, states often shortchange internal and external communications relating to the transformation, as well as compressing employee and citizen training and user acceptance testing. Compression cuts costs. This lack of attention to change management often has a direct impact on user adoption, which can significantly restrict the achievement of transformation goals and ROI.

Effective change acknowledges the need to enculturate a workforce in the realities of 21st-century budgeting, as well as providing adequate funding and resources, whether internal or external, to deliver related education and training. Much as businesses strive to be customer centric, government entities can become more citizen centric using performance-based budgeting. But that opportunity is often missed in the budget transformation process. With a workforce unaccustomed to citizen-centric behavior, paying attention to change management and resulting culture shift is crucial in large-scale service-improvement efforts.

#### Technological partnership – you don't have to go it alone

“The first rule of any technology used in a business is that automation applied to an efficient operation will magnify the efficiency. The second is that automation applied to an inefficient operation will magnify the inefficiency.”

Bill Gates, computer entrepreneur and business magnate<sup>4</sup>

As Gates reminds us, technology tends to make good things better and bad things worse. If processes are not thoroughly and soundly reengineered prior to automation, trouble often follows. Transformation can go awry without extensive collaboration between technology providers and budget and finance professionals, particularly in performance-based projects.

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#### Overcoming inadequate technology

The technologies that organizations use for financial management are often outdated, are poorly integrated, and rarely include leading budgeting applications. Because of this, undertaking an FPM initiative independent of a significant technology investment is difficult.

Thirty years since its introduction, spreadsheet software continues to be widely used in budgeting and financial reporting. But the technology is stretched to capacity amid growing public expectations and the sheer size and complexity of organizations. Version control problems, collaboration difficulties and general inefficiency can lead to inaccurate and incomplete planning and reporting, especially in more complex organizations. A simple error on one spreadsheet can cascade through the entire process, forcing personnel to focus on investigating errors instead of more productive work. It is extremely important that an FPM effort be supported by broad technology.

4. Rapid Prototyping and Engineering Applications: A Toolbox for Prototype Development (Mechanical Engineering), Sept., 26, 2007 by Frank W. Liou

Today's public sector budgeting technology enables state and local government agencies to go beyond traditional line-item budget creation into what-if scenario analysis, collaborative fiscal planning, point-and-click construction of management dashboards, and more. Rule-based budget automation tools trigger automatic data validation and consolidation, fund rebalancing, and scenario recalculation. Next-gen public sector software also standardizes data for

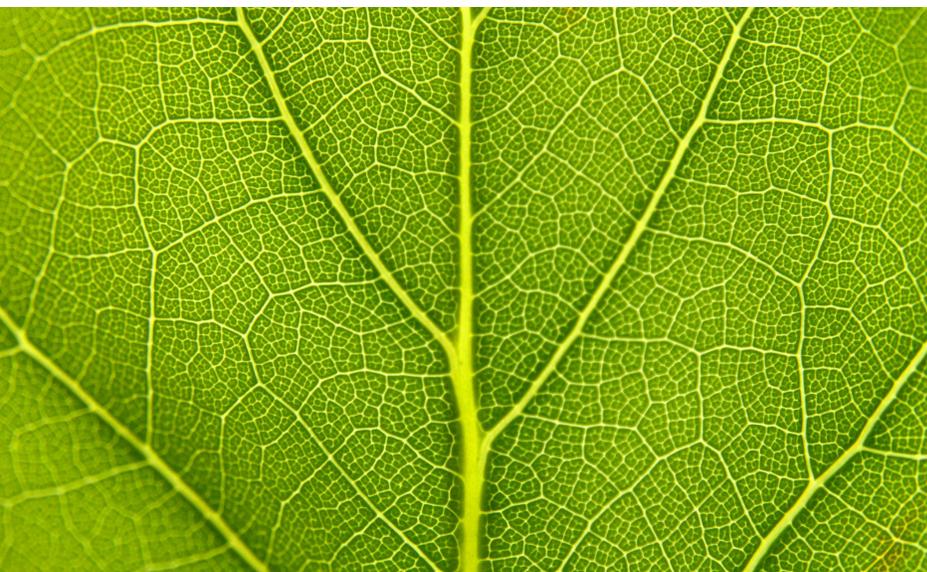
reporting, analysis, and audit, taking repetitive and error-prone tasks out of the hands of busy professionals and helping to empower them to focus instead on the vital task of budget strategy.

### Enhancing decision-making capabilities

FPM implementation provides public sector executives with a more comprehensive view of their organization and the means to help make better choices about service provision and resource allocation. This more holistic view allows executives to think more strategically about the services they provide and how to align those services with the changing needs and demands of citizens.

Also, rather than focusing on simply compiling and reporting information, FPM provides public sector managers with the means to conduct more thorough and useful analyses. By conducting program evaluations and assessing performance on a regular basis, public sector executives and legislative leaders can critically evaluate the programs and services they are directly responsible for and identify adjustments needed to improve effectively and efficiently.

Despite the advances in technological capability, these tools must still be deployed as one plank among several in a platform of progress. Forward-thinking state and local governments have begun looking to the broader expertise of firms with deep experience in integrating technology into the transformation process, rather than counting on software alone to repair deep-seated issues. This can be an important consideration since many, if not most, state IT departments are stretched thin just keeping up with day-to-day responsibilities. Asking them to take on the rigors of transformation in addition to their "day jobs" could, in a worst case scenario, impact their ability to deliver important services across state agencies and to the public.



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In the private sector, transformation projects are routinely subject to intense ROI analysis. Performance-based budgeting brings the same scrutiny to the public sector.

**Public sector insight – private sector leading practices often do not translate directly**

“It is our character that supports the promise of our future – far more than particular government programs or policies.”

William Bennett, Former  
U.S. Secretary of Education

In the *private sector*, transformation projects are routinely subject to intense ROI analysis. Performance-based budgeting brings the same scrutiny to the public sector. Since performance-based budgeting addresses every aspect of state and local government expenditure, even the budgeting process itself is now expected to provide a clear and fiscally accountable level of taxpayer value.

Adding to the urgency for transformation, budgeting in the public sector is often more complex than private-sector budgeting. While private-sector organizations source funding directly from undifferentiated revenue and operating margin dollars, state and local governments have additional layers of budget reporting and audit controls. State governments in particular often serve as both grantees and grantors, increasing the complexity.

FPM brings required accountability to budgeting by assigning responsibility, creating performance targets and rewarding results. Individual practitioners throughout the organization become directly accountable for the consequences of their decisions. Timely reporting allows responsible parties to take corrective action along the way. And, FPM enables the organization to evaluate and measure the financial consequences of policy and programmatic decisions.

FPM also promotes accountability for senior public sector executives. The comprehensive financial plan, a key system output, serves as a valuable communication vehicle, signaling to both internal and external stakeholders the organization’s priorities, direction and policies – all keys to quality constituent service.

**An approach to and for the future**

The public sector is rapidly changing, and government organizations need to keep up. They are constantly being asked to do more with less, produce higher quality services, and respond proactively to constituents’ needs. These trends are likely to continue and even accelerate as more baby-boomers retire, the need for state services grows, and technology adoption among the public expands. More effective budgeting processes are needed to help states target spending more effectively, reduce wasteful spending, and improve decision making at all levels.

FPM provides a framework spanning the processes and technologies related to performance management – from planning, budgeting and forecasting to reporting, performance measurement and compensation. And, FPM helps integrate them into one mutually reinforcing performance management system.

The recent availability of leading public sector budgeting solutions provides the required technology to make efficient FPM possible in the public sector. Formerly hierarchal and incongruent systems of planning, budgeting and performance measurement can be reengineered into a cyclical and integrated system of interrelated processes. The result is a system that supports more informed decisions and actions, and better understanding of consequences and outcomes.

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