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Public Sector

Mastering Finance in Government

Transforming the Government Enterprise
Through Better Financial Management

A Deloitte Research Study

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The Deloitte Public Leadership Institute, a part of Deloitte Touche Tohmatsu's (DTT) public sector industry group, identifies, analyzes and explains the major issues facing governments today. The focus of the Institute is to help public leaders tackle their most complex policy and management challenges. Through the Institute, Deloitte member firms deliver cutting edge thought-leadership, innovative solutions to issues facing governments and strategic policy development. With offices in Washington, DC, London, Ottawa and Sydney, the Institute delivers practical insights governments can use to improve their operations and deliver better value to their citizens. The Institute realizes these objectives through four major programs:

- **Thought leadership.** In conjunction with Deloitte Research, a part of Deloitte Services LP in the United States, Institute staff and Fellows produce provocative books, studies and commentaries on the most pressing issues facing public leaders.
- **Public leaders dialogues.** The Institute regularly brings together distinguished current and former senior public officials, management experts and academics to discuss topical issues and share best practices.
- **Benchmarking.** The Institute regularly surveys government executives to better understand the magnitude of 21st century challenges across government agencies. Survey data is then used to develop a clearer picture of the areas of greatest weakness and help to discern best practices that can be more widely disseminated.
- **Academic partnerships.** The Institute works closely with the world's leading graduate schools of public policy and administration to co-sponsor forums and co-produce books and studies.

About Deloitte Research

Deloitte Research, a part of Deloitte Services LP, identifies, analyzes, and explains the major issues driving today's business dynamics and shaping tomorrow's global marketplace. From provocative points of view about strategy and organizational change to straight talk about economics, regulation and technology, Deloitte Research delivers innovative, practical insights companies can use to improve their bottom-line performance. Operating through a network of dedicated research professionals, senior consulting practitioners of the various member firms of Deloitte Touche Tohmatsu, academics and technology specialists, Deloitte Research exhibits deep industry knowledge, functional understanding, and commitment to thought leadership. In boardrooms and business journals, Deloitte Research is known for bringing new perspective to real-world concerns.

Foreword

Put away the green eyeshades. Government finance is moving out from the back-office to become more strategic as government services transform to meet 21st century demands. 9/11 and Enron signify the importance of this transformation. Government missions are more complex amidst competing demands for efficiency and security. Likewise, transparency and accountability are on the rise as citizens expect greater insight into where their limited tax dollars are going.

Finance is now strategic. The finance group's contribution must move beyond its traditional role of support function to play a key role as the enabler of the complex missions for which government leaders are increasingly responsible. Public agency excellence is no longer defined merely as effective service delivery. More than ever, public organizations are being judged by their ability to achieve difficult undertakings, to successfully implement transformational changes. To do this requires sophisticated, proactive financial management. Moreover, when governments fail in their critical financial responsibilities, it undermines public credibility, perpetuates distrust, and makes citizens question whether public agencies are capable of performing their missions. In essence, poor financial management hurts the government brand.

For this report we surveyed more than 200 government leaders in 28 countries with the goal of understanding to what extent governments are trying to make finance more strategic. These survey results, we believe, represent the largest global data set in the world on finance transformation in government and provide a true baseline for others to compare themselves. What we found are significant gaps between current needs and capabilities but also a remarkable level of agreement about how government agencies need to strengthen and better integrate their finance capabilities.

This study represents part of our Deloitte Public Leadership Institute's ongoing efforts to combine primary research and firsthand client experiences into useful knowledge that you can use to make a difference.

We hope you find this useful.



Greg Pellegrino
Managing Director
Global Public Sector
Deloitte Touche Tohmatsu



Executive Summary

Increasingly the role of the finance function in organizations is to provide the financial insights that enable leaders to navigate troubled waters. In the public sector this entails everything from helping governments address looming fiscal challenges, such as rising entitlement, health care, pension, and infrastructure costs, to meeting new operational demands, such as a heightened focus on outcomes and increased transparency. Unfortunately, only one-third of government leaders believe they actually possess the financial management capabilities needed to address these and other critical challenges.

This is just one of the main findings of a global survey conducted by Deloitte Research. This survey of senior government officials representing more than 200 government organizations from 28 countries around the world makes up one of the largest global data sets on financial transformation in the public sector and provides an unprecedented look at the world of government finance. Taken as a whole, the survey tells us that government finance officials must surmount a number of significant, but attainable, hurdles to reach a maturity level that would justify their place at the executive decision-making table. The main findings of the survey can be broken down into several broad categories.

Finding #1: Significant Gaps Exist between Current Finance Capabilities and Government Needs

Survey respondents identified four areas in particular where financial management today often fails to serve the larger government enterprise.

1. Lack of up-to-date information for decision making.

A prerequisite for good decision making is access to timely, reliable, and accurate data, including financial data. Yet such financial information is the exception, rather than the rule. Sixty-nine percent of the public officials surveyed cited a lack of up-to-date information as either a moderate or significant barrier to improving the organization's performance.

2. Poor information on costs. Fully 63 percent of respondents said that program managers do not understand the total cost of their services.

3. Incomplete understanding of the relationship

between investments and outcomes. More than half of those surveyed indicated that their organizations do not thoroughly understand the relationship between the investments they make in programs and the outcomes those programs produce.

4. Inadequate risk management. Only 27 percent of those surveyed described their organization's capabilities in this area as having moved beyond a basic level. This deficiency increases the risks of error and fraud and can mask the actual financial health of an organization.

Finding #2: Finance Functions Today Perform Better in the Tactical Roles than in the Strategic Roles

To achieve their full potential, finance functions within government organizations must perform a variety of critical finance roles. These roles can be broken into four categories: Steward, Operator, Strategist, and Catalyst. A look at these "four faces of finance" helps assess where a finance organization currently stands, and whether it is well positioned to support and drive enterprise transformation.

Steward: The Steward role entails protecting and preserving the assets of the organization and keeping the books accurately.

Operator: The Operator function helps ensure prudent use of resources by standardizing, consolidating, and automating processes and systems to eliminate redundancy and develop shared services.

Strategist: The Strategist role influences the organization's overall direction by providing financial leadership for government initiatives. It does so by providing relevant, accurate, and timely financial information to decision makers.

Catalyst: The Catalyst instills a financial mindset across government by partnering with government program executives and leaders from IT, HR, and other functions to drive organizational behavior and focus on efficient execution.

The ultimate goal is achieving the status of a Finance Master, a finance function that excels at all four roles at the same time. This is an ideal to which organizations can aspire, but not a common condition in today's public sector finance world, according to the survey findings.

Most organizations surveyed have far more mature capabilities as Stewards and Operators than as Strategists and Catalysts. That is, most finance organizations do better in the tactical roles (Steward and Operator) than at the strategic roles (Strategist and Catalyst). These strategic roles are clearly most often the weakest areas of financial management today and also the ones most critical to addressing many of government's biggest fiscal and operational challenges.

Finding #3: Finance Mastery in Government Is Achievable

Our survey suggests that the greatest need in government finance today is for a finance function that can offer timely information and advice to government leaders on key operational and strategic decisions. This requires finance functions to go beyond the core finance capabilities of Steward and Operator—mere table stakes in today's world—to enhance their financial capabilities as Strategist and Catalyst. More than half of the respondents believe that the finance organization is the unit best placed to move the organization as a whole to a greater focus on value, but also say it now lacks the combination of sufficient capabilities and resources needed to make a greater contribution to the organizational mission.

Fortunately, as governments enhance their financial capabilities, they can learn a lot from those public organizations on the forefront of financial transformation, what we call Finance Masters. We define a Finance Master as:

An organization with a finance function that supports the business in making strategic decisions and that acts as a catalyst for change, built on a foundation of excellence in finance stewardship and operations.

Most government organizations face a challenging path on the way to becoming Finance Masters. In fact, nearly 42 percent of respondents said they had not yet mastered the core stewardship and operational functions of public finance needed to build the foundation for financial excellence. We call this group of organizations Novices.

Another 27 percent of government agencies, what we call Intermediates, said they had made significant inroads in building their capabilities as Stewards and Operators, but they have yet to effectively build capabilities to help governments make better strategic choices, improve processes, and boost performance.

The remaining 24 percent represent Finance Masters. These organizations have built on their core finance capabilities, gaining the capacity to serve government decision makers as both Strategist and Catalyst. They have taken a journey of finance transformation that sets them apart from their peers, and they now provide real value to their organization over and above the expected: They are able to provide real-time financial information, give accurate and activity-level cost information, show the relationship between investment and outcomes, and ensure accountability. These Finance Masters represent the “to be” state for most government organizations.

Finding #4: The Path to a Finance Master Involves a Two-Stage Process

The path to finance excellence is built first on excellence in finance stewardship and operations. This step entails developing analytical capabilities and improving on Steward and Operator roles. Novices must close several key gaps in core capabilities before they can move to a more advanced stage.

The next step is to provide more strategic insight. Government organizations use their strong analytical abilities to develop Strategist and Catalyst roles and then proactively seek out areas within the organization in which financial insight can benefit the mission.

To move up the curve to Finance Master, Intermediates must acquire a set of capabilities that help government agencies first determine *what* they should do and second, *how* they should operate. By adopting this set of more sophisticated capabilities, Finance Masters play a critical role not only in transforming the government finance function itself but also in improving the business of government—both in helping government leaders make more strategic decisions about how to spend scarce resources and measure results, as well as in showing how government should operate to achieve these goals.

Introduction

Governments around the globe face unprecedented challenges. In many cases, they are seeking to dramatically transform the way they serve citizens. Too often, however, governments fail to take advantage of a tool that in the private sector is becoming a key source of competitive advantage—the use of financial data to help manage and inform the needed transformation.

This is just one of the main findings of a global survey conducted by Deloitte Research. The survey of senior government officials representing more than 200 government organizations from 28 countries around the world makes up one of the largest global data sets on financial transformation in government, and provides an unprecedented look at the world of government finance. (See Appendix A for a profile of survey respondents.)

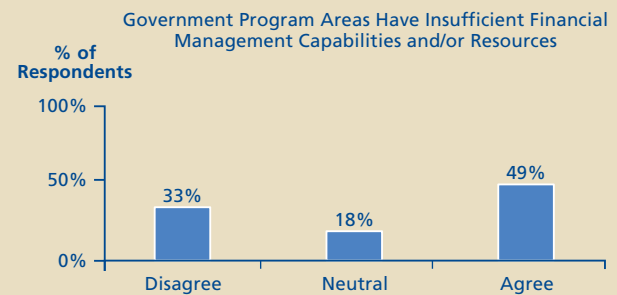
Covering all major sectors of government, the survey was designed to answer key questions about the finance function within government such as: What does the future hold for government finance? How can finance leaders in the public sector take their organizations from where they are today to a new level of performance, creating greater value for the citizens they serve?

The picture uncovered was of a function mired in the past. Despite significant progress over the past decade in streamlining transactional efficiency, in too many cases government's finance function fails to meet the needs of the larger enterprise.¹ Sophisticated financial insight capabilities are increasingly needed to address looming fiscal and operational challenges, but in most cases governments simply do not have such capabilities. Close to half the government officials we surveyed believe their organizations do not possess adequate financial management capabilities (figure 1).

As a result, governments often relegate the finance function to the “back room,” where the focus is mainly on paying the bills, tracking the money, auditing the finances, and generating standard reports. Studies of government financial management systems have consistently found them to be outdated and difficult to integrate with other systems.²

Further complicating government financial management is how diffuse most government finance functions are from an organizational perspective. Unlike the private sector, few governments have enterprise-wide chief financial officers with visibility and authority across the whole organization. Instead, responsibilities tend to be fragmented across multiple elected, appointed, and career officials, as well as across individual agencies. Many jurisdictions have comptrollers, treasurers, chief auditors, budget directors, and chief finance officers—all with different and sometimes competing responsibilities.

Figure 1. Inadequate Financial Management Capabilities



Source: Deloitte Research Global Survey on Finance Transformation

The picture however is not entirely grim. The survey results also show the early indications of a marked shift. A growing number of governments have recognized that, as with their private sector counterparts, world-class finance functions create value by providing strategic insight and decision-making support to the enterprise. They do so in a variety of ways: they shine a spotlight on underperforming programs, comparing what is spent to the outcomes achieved; they help wring out inefficiencies by providing a picture of fully allocated costs; they identify and manage the organization's financial risks to protect its fiscal well being; they quantify the trade-offs between the different policy options on the table; and they provide detailed information on true lifetime costs attached to particular decisions, so that future liabilities are properly understood.

These “finance masters” understand that increasingly, the operational challenges governments face today demand sophisticated and flexible financial management capacities. Whether they are trying to provide better emergency response, tackle the challenge of aging populations, or improve education, governments face pressure to provide effective services with limited resources. Budget constraints require agencies to deliver services more efficiently and effectively, and technological innovations make it more feasible to do so. Moreover, governments also face pressure to demonstrate better value for each dollar spent, such as by reducing fraud in benefit payments and contracts. Governments find that better managing their financial resources is critical for improving performance in all these areas. This report finds strong evidence that creating better value by supplying timely financial insight is a growing trend among public finance functions.

In short, government transformation requires finance transformation. The survey findings show that many public finance organizations are ripe for just such a profound transformation. This report illuminates a pathway from traditional scorekeeping and transactional duties to one in which the finance function provides the tools for informed decision making, thus earning a seat at the executive table. In the private sector, finance plays a key role in guiding strategy. In the coming years, public financial systems should similarly help drive organizational productivity and resource allocation.

This report explores how to make this transformation happen. Our focus is on how financial transformation can help public organizations improve performance and better accomplish their core missions.

We start by illustrating the external challenges facing government and show why meeting these challenges cannot be accomplished without a strong finance function.



The Imperative for Finance Transformation in Government

Governments today face unprecedented demands. A new, more sophisticated role for finance will be critical to meeting these difficulties. Consider just a few of the daunting fiscal challenges alone:

- Rising entitlement, health care, and pension costs
- Paying for near- and long-term capital needs
- Balancing the needs of today's older citizens with those of future generations

Fiscal Challenges

Rising Health Care, Entitlement, and Pension Costs

For the first time in history, most developed countries now have inverted population pyramids. The number of elderly is rising, while the birth rate is falling below the replacement rate. This demographic shift brings a corresponding transfer of resources. The Organization for Economic Cooperation and Development (OECD) projects that, on average, public transfers to retired beneficiaries in OECD countries will jump from 21 to 27 percent of gross domestic product (GDP) by 2050.

In countries such as Belgium, France, Germany, and Italy, public pension outlays as a percentage of GDP are expected to reach 13–14 percent—levels that may negatively impact economic growth.³

The aging population presents a major fiscal predicament for governments in other areas as well, particularly health care and long-term care, as rising life expectancies, and the associated increases in debilitating illnesses, drive up health care costs. In many countries, the costs of social security and other old-age pension and health care programs threaten to crowd out spending on other public programs.

The challenge for financial transformation from rising health care, pension, and entitlement costs is that it leaves very little room for maneuvering in all the other areas of government responsibility. Not only do governments need to do something to rein in these costs, but they have to figure out how to do so while maintaining existing services. To enable governments to meet these increasing demands, the finance function will need to add value through new means.

Paying for Long-Term Capital Needs

Governments worldwide also struggle with how to budget and pay for significant long-term capital needs at a time when resources are tight. How can they address deep structural challenges in budgets driven primarily by rising health care costs and pension liabilities while also maintaining aging infrastructure and addressing future infrastructure needs?

Infrastructure needs for the European Union, for example, run into trillions of dollars. Approximately \$90 billion is needed for infrastructure investment in Germany alone each year.⁴ In Australia, the government has instituted a \$20 billion fund to cover high-priority infrastructure requirements.

These looming challenges are likely to require innovative financial solutions such as public-private partnerships, the long-term leasing of assets, and the generation of new revenues through other creative mechanisms.

Balancing Intergenerational Needs

In the wake of rising entitlement and infrastructure costs, government leaders also struggle to balance the needs of retirees with those of younger citizens—while still holding taxes to politically acceptable levels. In the United States, unfunded pension obligations could exceed \$600 billion across the public and private sectors. Meanwhile, the bill for paying future medical benefits for retiring U.S. state and local government employees could top \$1 trillion.⁵

More and more, policy makers are concerned with “budget honesty” and “intergenerational accountability.” They want to better understand how decisions made today will affect citizens decades from now. Australia's Charter of Budget Honesty, for example, mandates an intergenerational report every five years to evaluate how certain policies distribute resources and responsibilities among the generations. This policy gives the public a chance to see what the per capita fiscal burden of tomorrow's generation will be and easily compare it to today's burden.

Performance & Operational Challenges

These fiscal pressures in turn are creating pressures for governments to spend taxpayer money more wisely and achieve greater value for money. Any solution to the problem will entail among other things a heightened focus on outcomes and increased transparency of financial information.

Heightened Focus on Outcomes

In the wake of continuing fiscal challenges, input-oriented budgeting practices are steadily giving way to new outcome-based approaches that measure success by the results achieved, not by the amount of money spent. Today's public managers are expected to set tangible goals—and to achieve them.

An outcome-based approach clarifies what is being produced and what it costs. With increased transparency around performance and outcomes, citizens can actually see what their tax monies buy and more easily monitor progress toward public goals. As mandatory spending consumes an ever-greater piece of the government pie, public managers are likely to feel increased pressure to justify their use of diminishing discretionary funds.

Moving to an outcome-based approach requires extremely sophisticated finance and budgeting capabilities. Performance-based budgeting, for example, is more complex than traditional budgeting, which often requires little more than tweaking the previous year's budget. The ability to measure and evaluate results is a necessary, but not a sufficient, prerequisite to delivering effective services. So too is the ability to demonstrate a reasonable connection between actions and outcomes.

Increased Transparency

High-profile scandals and financial crises such as the subprime mortgage debacle have added to the demand for greater transparency in both the private sector and the public sector finance functions.

Fallout from the passage of the Sarbanes-Oxley financial regulation in the United States encouraged the U.S. federal government to revisit the state of its own internal controls. Operating much as Sarbanes-Oxley does for private companies, revised U.S. Office of Management and Budget Circular A-123 imposes stricter internal controls on financial reporting in federal agencies. The goal is to provide reasonable assurance that agencies are in compliance with laws, safeguarding their assets against abuse, and properly accounting for their transactions. It is no longer sufficient for an agency just to assert that it has put proper internal controls in place. Now, the heads of the 24 largest federal agencies must demonstrate that they have implemented these financial reporting controls.

In Canada, the Federal Accountability Act, enacted in 2006 in response to a series of scandals, aims to make government more transparent and to crack down on unethical actions. Key features include cleaning up contracting and appointment processes to discourage the potential for political patronage; the creation of an independent parliamentary budget officer to analyze the way the government manages its financial planning; and the development of protocols to offer "ironclad protection" for whistleblowers.

To further increase transparency in the U.S. government, Congress passed and the president signed the Federal Funding Accountability and Transparency Act in September 2006. Thanks to this legislation, members of the public now can access a Website that provides information on all government funding initiatives and contracts.⁶

Meanwhile, in 2004 the Brazilian government unveiled its "Portal of Transparency," an online channel where citizens can access detailed data at the federal, state, and local level, about government expenditures, purchases, and contracts. Citizens can go to the site, www.portaltransparencia.gov.br/, and track how public resources are being used both by federal agencies and in the locality where they live.

Gaps in Finance Function Capabilities

Chief financial officers (CFOs) and their equivalents, by virtue of their unique role within an organization, hold key information needed to steer public sector organizations toward success in their missions. While government leaders may articulate a vision, it is the decisions—policy, political, and financial—made day in and day out that really chart an organization’s course. Increasingly the role of CFOs, and the professionals who report to them, is to provide the financial insights that enable political leaders to navigate troubled waters.

In leading public organizations, political leaders define their organization’s true north, while financial officers help to map the organization’s path toward that target. Translating the vision of the organization into financial terms enables leaders to make informed choices among competing priorities such as whether to fund smaller class sizes or more public infrastructure.

In too many cases, however, despite having invested significant time and energy getting their financial house in order in recent years, most public sector organizations still cannot produce the timely financial information needed to optimally manage everyday business operations. In some cases, they are still using manual approaches because their incompatible financial systems don’t allow them to easily synchronize data.

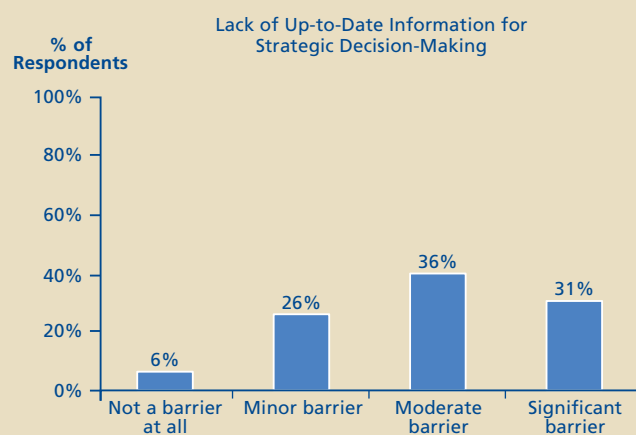
This poses a significant challenge for getting decision makers the kind of useful information they need. In government organizations that suffer from these deficiencies, finance remains stalled in its traditional role, merely cutting the checks and keeping the books, rather than supporting the strategic mission.

Areas Underserved by Finance

Survey respondents identified four areas in particular where financial management today often fails to serve the government enterprise.

1. Lack of up-to-date information for decision making
2. Poor information on costs
3. Incomplete understanding of the relationship between investments and outcomes
4. Inadequate risk management

Figure 2. Lack of Up-to-Date Information Viewed as Key Barrier to Operational Excellence



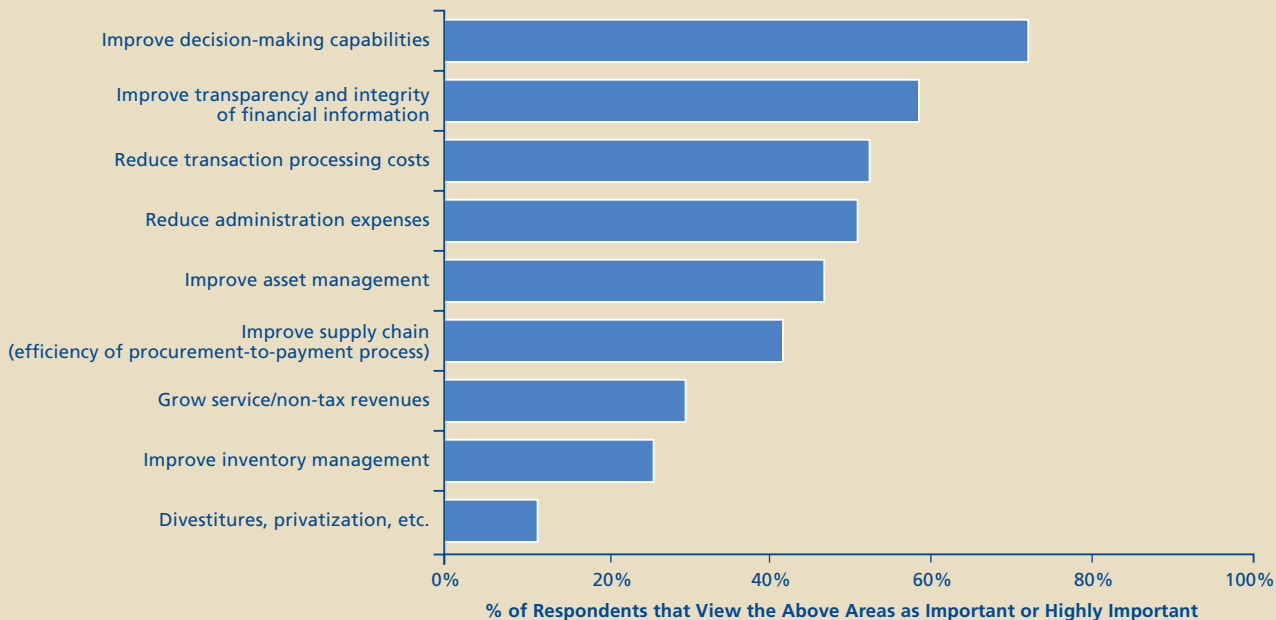
Source: Deloitte Research Global Survey on Finance Transformation

1. Lack of up-to-date information for decision making

A prerequisite for good decision making is access to timely, reliable, and accurate data, including financial data. Yet such financial information is the exception rather than the rule. Sixty-seven percent of the public officials we surveyed cited the lack of up-to-date information as either a moderate or significant barrier to improving the organization’s performance (figure 2).

Recognizing this shortcoming, public officials cite the ability to produce more relevant and up-to-date financial information to support decision making as their top priority for improving financial performance in the next three years (figure 3).

Figure 3. Top Priorities for Improving Financial Operations



Source: Deloitte Research Global Survey on Finance Transformation

2. Poor information on costs

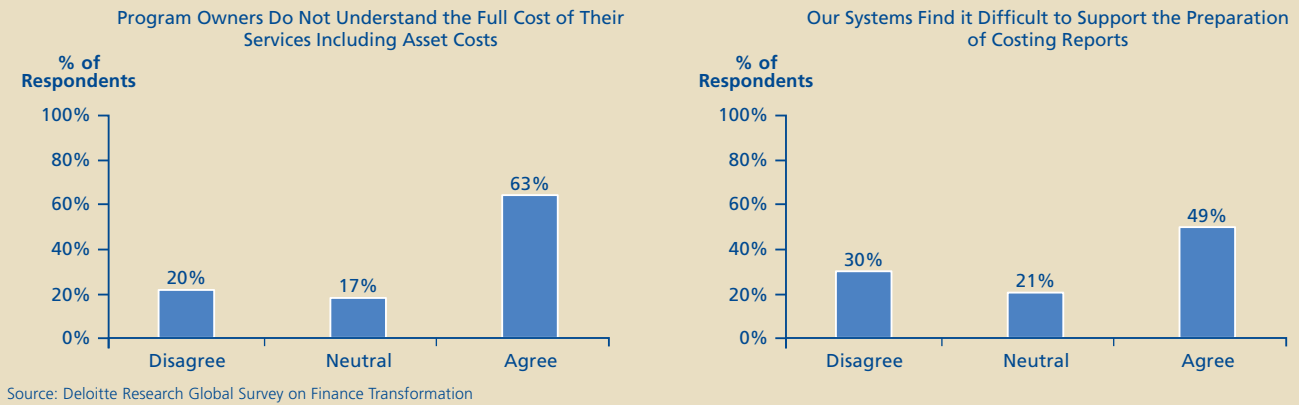
Under pressure to reduce costs, public officials are always looking to streamline their business operations. But before they can determine how to wring out inefficiencies without hurting service quality, they must understand the true costs, both direct and indirect, of delivering programs and services.

Unfortunately, many public organizations find it difficult to calculate fully allocated costs of specific activities. Fully 63 percent of respondents say that program managers do not understand the total cost of their services, including asset costs (figure 4). Contributing to the haze, only a quarter of finance officials indicate that their agencies regularly prepare cost-of-service reports. In many cases, existing financial systems do not sufficiently support the generation of such reports except through labor-intensive manual processes. Because their organizations do not fully understand the cost of operations, programs, and service delivery, public officials cannot readily identify opportunities to reduce costs. Nor can they establish meaningful benchmarks for measuring financial performance.

3. Incomplete understanding of the relationship between spending and results

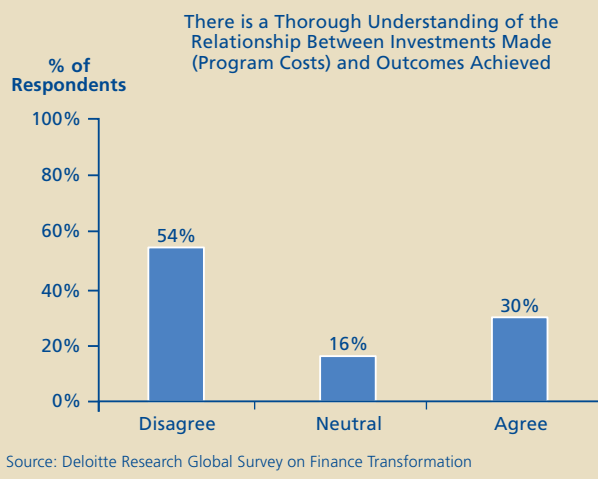
Responding to pressure to deliver better value for money, a results-oriented approach to operations focuses on the results rather than on the inputs. It evaluates the quality and impact of program and service delivery and uses performance measurements to determine success. Before they can do that, however, program managers need several key pieces of information. First, for public managers to distinguish between programs that work and those that don't, they need information on program performance. Second, they need to know how much it costs to buy those desired results, so that they can prioritize program funding. In other words, if programs *a* and *b* produce the same results, but *b* costs three times as much as *a*, then program *a* merits additional resources whereas program *b* should be re-evaluated.

Figure 4. Poor Data on Costs



Unfortunately, many government finance functions do not have effective mechanisms to collect this kind of data. One consequence is that, as we have seen above, public finance organizations often lack good costing information. Not surprisingly, more than half of the finance officials surveyed indicate that their organizations do not thoroughly understand the relationship between the investments they make in programs and the outcomes those programs produce (figure 5). Another consequence from a financial perspective is inaccurate financial reporting, which in turn leads to bad decision making.

Figure 5. Understanding the Relationship Between Investments and Outcomes



4. Inadequate Risk Management

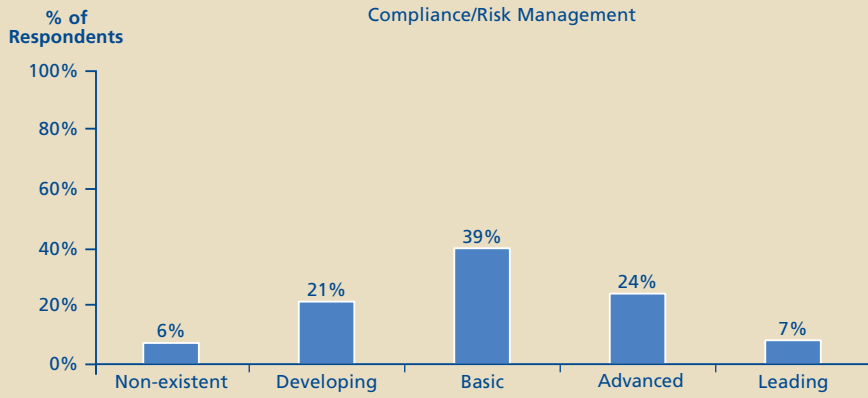
Internal controls help keep public agencies accountable to the public. They highlight those areas of the organization that are at greatest risk for fraud, waste, and mismanagement. Without effective internal controls, issues tend to make it onto the radar screen only after a problem occurs.

Proactive risk management and strong internal controls are needed for effective governance and to stay within the bounds of the law. Despite this, compliance and risk management capabilities remain inadequate in many public organizations. Only 31 percent of those surveyed describe their organization's capabilities in this area as having moved beyond a basic level. This increases the risks of error and fraud and can mask the actual financial health of the organization (figure 6).

Moreover, more than half of the financial officials report that their organization's ability to audit its own financial accounts falls at or below a baseline level of development.⁷ And only slightly more than one-quarter of the survey respondents indicate that their organization has advanced or leading capabilities when it comes to identifying, managing, and reporting risks (figure 7). These survey findings mean that many organizations are failing to perform key tasks required to ensure accountability.

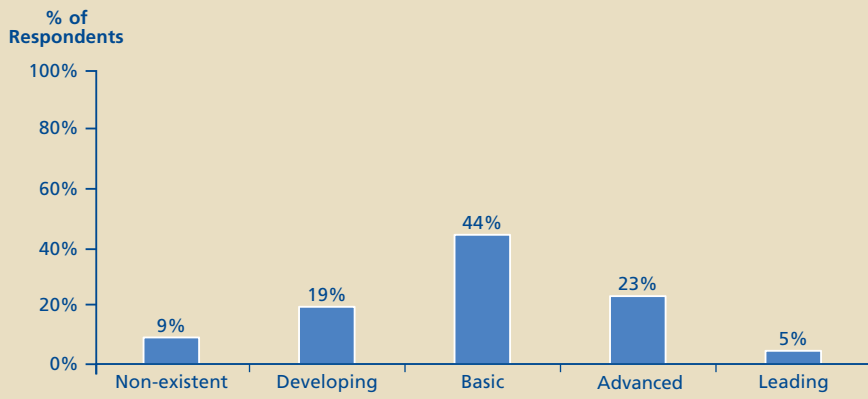
Source: Deloitte Research

Figure 6. Assessment of Compliance/Risk Management Capabilities



Source: Deloitte Research Global Survey on Finance Transformation

Figure 7. Capabilities to Identify, Manage and Report Risks



Source: Deloitte Research Global Survey on Finance Transformation

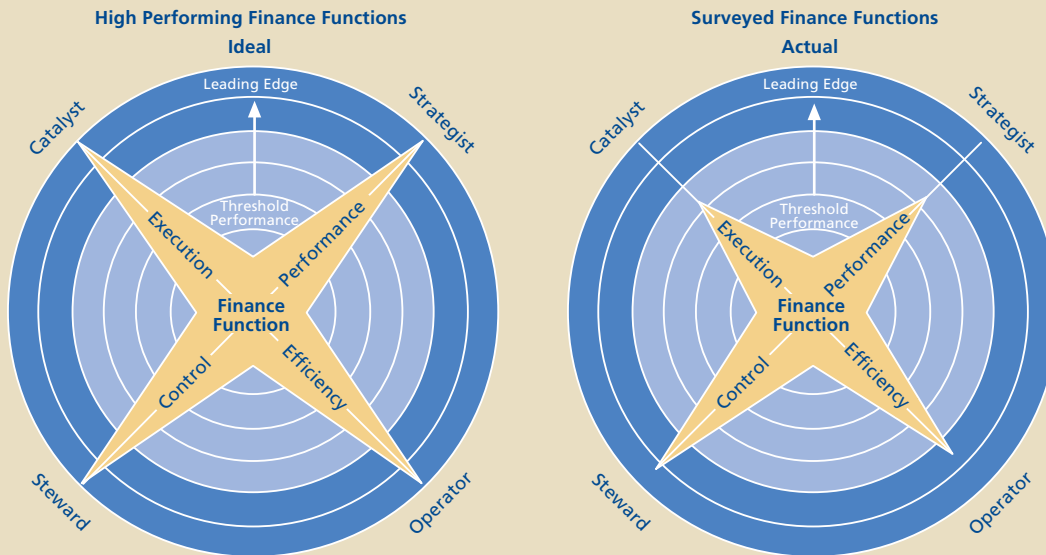
Modeling the Finance Function: Pathway to the Future

How can public finance functions best drive and support their organization's mission? The short answer is that they have to be good at everything. But what is everything? The following model, developed by Deloitte for looking at the finance operation, first helps the organization evaluate where it currently stands and then provides a path to a future in which finance adds greater value than ever before.

To achieve their full potential, finance functions within government organizations must perform a variety of critical finance roles. These roles can be broken into four categories: Steward, Operator, Strategist, and Catalyst. A look at these "four faces of finance" helps assess how well positioned a finance organization is to support and drive enterprise transformation.

- **Steward:** The Steward role entails protecting and preserving the assets of the organization and keeping the books accurately. A good Steward protects and preserves the public trust by executing the day-to-day financial recordkeeping at a detailed level, scoring well on audits, setting high standards of internal controls, and having effective budgeting, planning, and forecasting systems. A good Steward also maximizes government revenue generation by cutting fraud, waste, and abuse.
- **Operator:** The Operator function helps ensure prudent use of resources by standardizing, consolidating, and automating processes and systems to eliminate redundancy and develop shared services. A good Operator applies forward-looking financial tools such as scenario planning to maximize the organization's financial resources.
- **Strategist:** The Strategist role influences the organization's overall direction by providing financial leadership for government initiatives. It does so by providing relevant, accurate, and timely financial information to decision makers. A good Strategist uses the budget to drive government's high-level strategy and provides financial analyses to help government organizations monitor their progress to meeting improved outcomes.
- **Catalyst:** The Catalyst instills a financial mindset across government. A good Catalyst partners with government program executives and leaders from information technology, human resources, procurement, and other functions to drive organizational behavior and focus on efficient execution. This includes providing a full suite of services for implementing enterprise-wide financial, HR, tax, and revenue systems to support more efficient and integrated operations. A good Catalyst also prepares accurate and consistent costing information that is critical for allowing program areas to identify opportunities for increasing service delivery efficiency.

Figure 8. The Four Faces of Finance: Finance Master (Ideal) vs. Actual



Source: Deloitte Research Global Survey on Finance Transformation

These roles are complementary, not exclusive (see Appendix B), with something of a progression associated with these roles. An organization that is weak as a Steward would be unlikely to play a key role as a Catalyst. It is possible, however, for an organization to be at different levels in all four roles and to be developing at different rates in different functional areas.

The ultimate goal is achieving the status of Finance Master, a finance function that excels at all four roles at the same time. This is an ideal to which organizations can aspire, but it is not a common condition in today's public sector finance world. Figure 8 depicts graphically the four faces of finance, showing on the left-hand side a Finance Master in which all roles are performed at the highest *leading edge*-level. Analyzing government departments along these four dimensions of finance allows us to rank their actual capabilities along a maturity model from leading to nonexistent. (See Appendix A for further details on the finance capability maturity model.)

The right-hand panel in figure 8 represents *the actual state* of most finance functions of government departments, based on the survey results. As is clear from the figure, most organizations surveyed have far more mature capabilities as Stewards and Operators than as Strategists and Catalysts. That is, most finance organizations do better in the tactical roles (Steward and Operator) than at the strategic roles (Strategist and Catalyst).

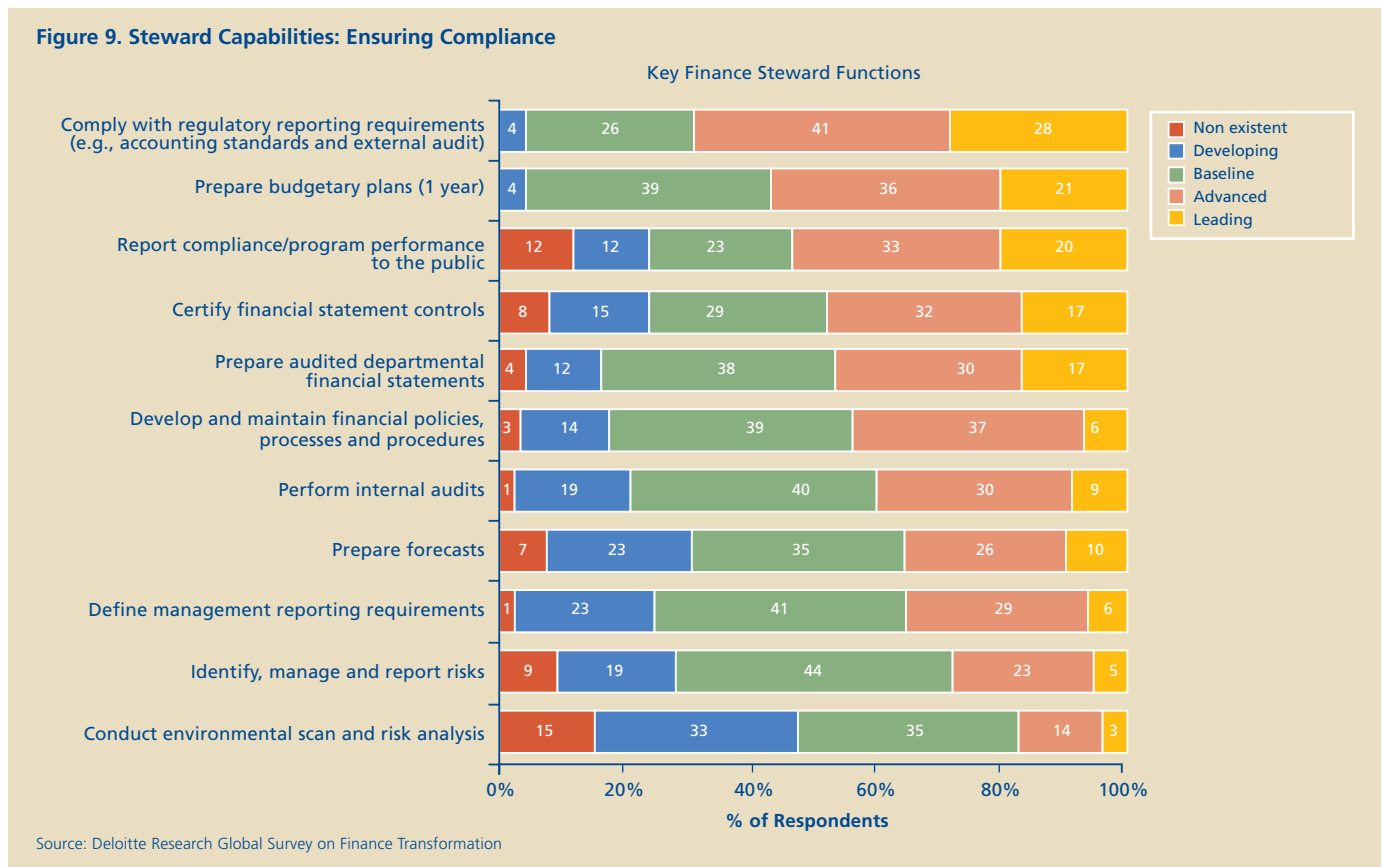
To assess where an organization lands within each of the four roles, we analyzed responses to a set of survey questions relating to each role.

Steward

The survey results show that most governments believe they have relatively strong core Steward finance capabilities—that is, they comply with legislative statutes, they report program performance to the public, and they are good at preparing budgetary plans (57 percent of the respondents reporting advanced or leading capabilities in this area). Some still struggle, however, in areas of greater impact, such as conducting internal audits and preparing forecasts (figure 9).



Figure 9. Steward Capabilities: Ensuring Compliance



Operator

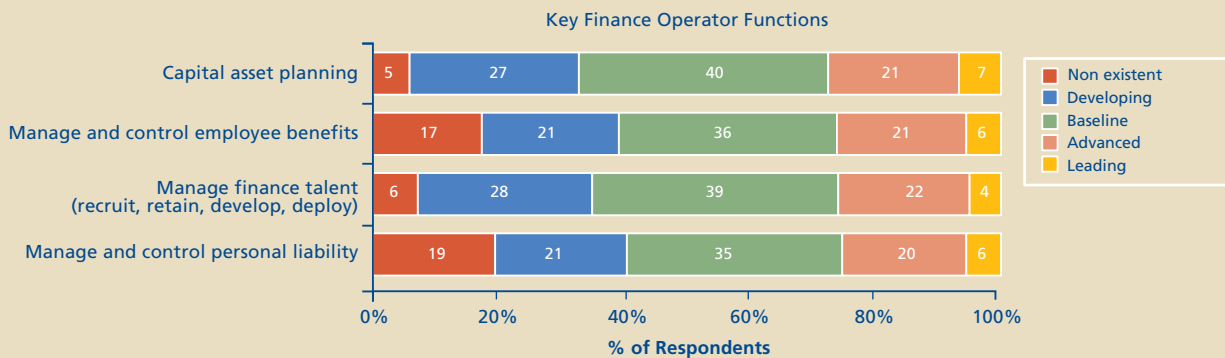
The survey's assessment of the Operator role focuses on the ability to drive a more efficient finance operation across the organization. This includes everything from managing the fiscal implications of personnel issues—such as the budget consequences of providing higher levels of health care insurance—to the financial benefits of moving to shared service models for back-office functions like accounts payable and payroll. Within most of the Operator roles, less than one-third of respondents are at the advanced or leading level (figure 10). For example, only 26 percent have advanced or leading capabilities in the areas of managing talent and managing and controlling pension liability.⁸

Strategist

The finance function's ability to weigh in with key financial data on current and future costs makes it a critical player in major strategic decisions and policy development.

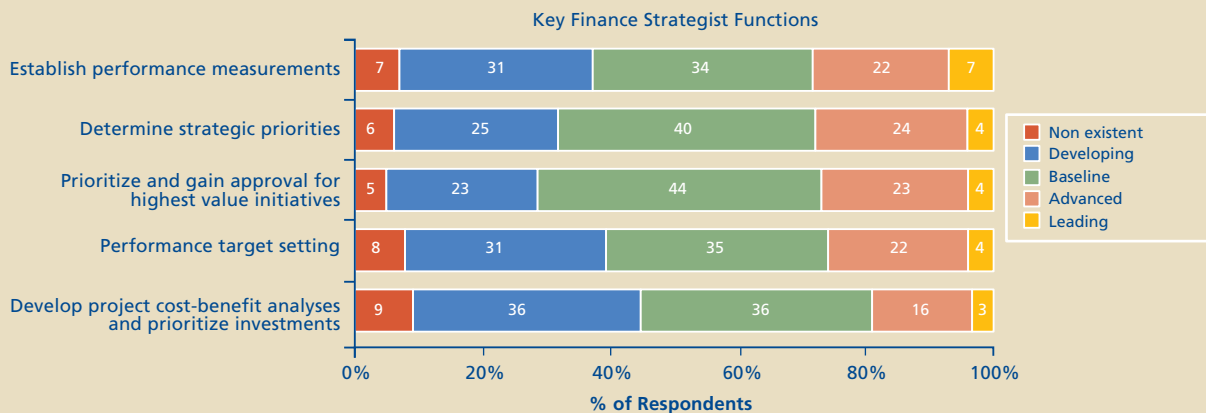
Most organizations have yet to develop advanced or leading capabilities in most Strategist areas (figure 11). When it comes to determining strategic priorities, developing cost-benefit analyses of projects, and prioritizing initiatives, less than a fourth of respondents have advanced capabilities, and even fewer have leading capabilities. Bottom line: Most organizations have limited strategic capabilities.

Figure 10. Operator Capabilities: Driving Efficiency



Source: Deloitte Research Global Survey on Finance Transformation

Figure 11. Strategist Capabilities: Influencing Leaders



Source: Deloitte Research Global Survey on Finance Transformation

Catalyst finance role in action in Denmark

In 2005 the Danish Tax Department merged its local and central tax divisions to create a unified body called SKAT. The finance division helped the department re-engineer its business processes and redesign its governance structure to achieve cost reductions of 25 percent within four years.

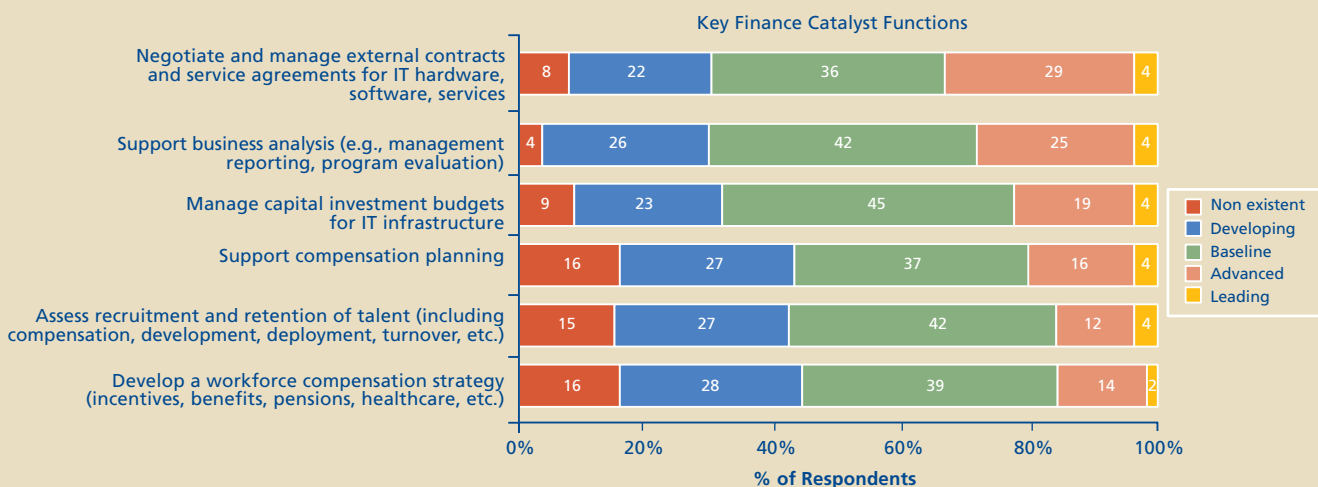
Catalyst

The Catalyst role of financial management centers on execution—using financial tools and data to actually implement key government strategies and initiatives across the enterprise. The catalyst does this by serving as a business partner to other decision makers, including business unit leaders, the chief information officer, chief administrator, chief procurement officer, and chief human resource (or human capital) officer.

Like the Strategist role, the survey indicates that the Catalyst capabilities in the finance function are generally quite immature. Finance’s role in supporting key human capital issues, such as workforce compensation strategies and recruitment and assessment of talent, is mostly at the developing or baseline stage (figure 12).

While core finance operations—the Steward and Operator roles—can still be challenging for many respondents, many report their capabilities in these areas to be solid or improving. More worrisome is the large majority of organizations struggling in the other two faces of finance, the roles of Strategist and Catalyst. These are clearly most often the weakest areas of financial management today and also the ones most critical to addressing many of government’s biggest fiscal and operational challenges.

Figure 12. Catalyst Capabilities: Enhanced Execution Abilities Through Finance



Source: Deloitte Research Global Survey on Finance Transformation

Achieving Finance Mastery

While much previous research has focused on the efficiency and effectiveness of core financial functions, our research has gone well beyond this analysis.⁹ Our survey suggests that the greatest need in government finance today is for a finance function that can offer timely information and advice to government leaders on key operational and strategic decisions. This requires finance functions to go beyond the core finance capabilities of Steward and Operator—mere table stakes in today’s world—to enhance their financial capabilities as Strategist and Catalyst. In fact, a limited financial support function is a major barrier to bringing the organization as a whole to a new level of public service.

Most government organizations recognize the need to develop more sophisticated finance capabilities. Our survey shows that 67 percent of the respondents see financial management as holding the potential to bring positive change to the organization. More than half of the respondents believe that the finance organization is the unit best placed to move the organization as a whole to a greater focus on value. But more than half the organizations surveyed said they lacked the combination of sufficient finance capabilities and resources needed to make a greater contribution to the organizational mission.

Fortunately, as governments enhance their financial capabilities, they can learn a lot from those public organizations on the forefront of financial transformation that we call Finance Masters. We define a Finance Master as:

An organization with a finance function that supports the business in making strategic decisions and that acts as a catalyst for change, built on a foundation of excellence in finance stewardship and operations.

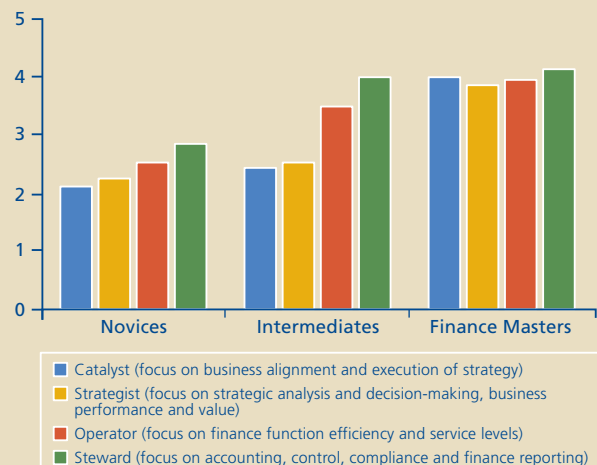
Most government organizations face a challenging path on the way to becoming Finance Masters. In fact, nearly 42 percent of respondents said they had not yet mastered the core stewardship and operational functions of public finance needed to build the foundation for financial excellence, such as providing high-quality information, complying with regulatory requirements, controlling employee benefits and pension liabilities, and managing reporting requirements. We call this group of organizations Novices.

Another 27 percent of government agencies said they had made significant inroads in building their capabilities as Stewards and Operators, but they have yet to effectively build capabilities to help governments make better strategic choices, improve processes, and boost performance. The term we use for organizations that fit into this category is Intermediates.

The remaining 24 percent represent Finance Masters. These organizations have built on their core finance capabilities, gaining the capacity to serve government decision makers as both Strategist and Catalyst. They have taken a journey of finance transformation that sets them apart from their peers, and they now provide real value to their organization over and above the expected. They are able to provide real-time financial information, give cost information, show the relationship between investment and outcomes, and ensure accountability (figure 13). These Finance Masters represent the “to be” state for most government organizations.

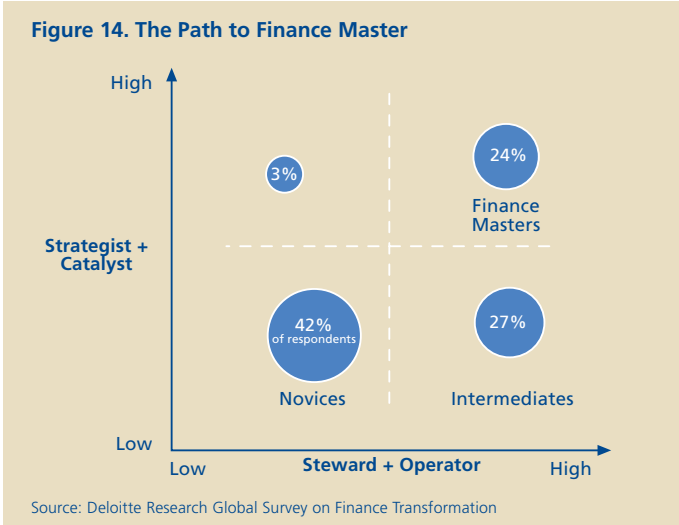
Of the remaining 7 percent of respondents, 3 percent identify themselves as having strong capabilities as Strategists and Catalysts but falter at the core functions associated with being Stewards and Operators; the remaining failed to provide complete answers that would allow us to categorize them into one of these groups.

Figure 13. How Finance Masters Compare Across the Four Faces of Finance (Scale of 1-5)



Source: Deloitte Research Global Survey on Finance Transformation

Figure 14. The Path to Finance Master



Our analysis also reveals a key aspect of finance transformation. The path to finance excellence is built on excellence in finance stewardship and operations. With only a few exceptions, almost no organization in our analysis has been able to master Strategist and Catalyst capabilities without a foundation in Steward and Operator capabilities (figure 14).

What is more, the Finance Masters as defined in this study have in many cases stronger Steward and Operator capabilities than the Intermediates. Thus, mastering finance as Strategists and Catalysts does not mean that Steward and Operator capabilities can be neglected. If anything these core capabilities need to be as robust as possible. The path to becoming a Finance Master thus involves a two-stage process.

1. Improve core capabilities. This step entails developing analytical capabilities and improving on Steward and Operator roles. This will be the main initial focus of organizations trying to climb out of the Novice category.

2. Provide strategic insight. In this stage, government organizations use their strong analytical abilities to develop Strategist and Catalyst roles. This is the transition Intermediates must make to become Finance Masters.

Stage One: Improve Core Capabilities

Our surveys show that many government agencies are in the Novice stage of financial transformation. They have many of the necessary Steward/Operator capabilities but still lack some of the skills they need to move to a more advanced stage of development. Our survey results show four key gaps that Novices must close before they can become Intermediates and then Finance Masters.

Stage One: Improve Core Capabilities

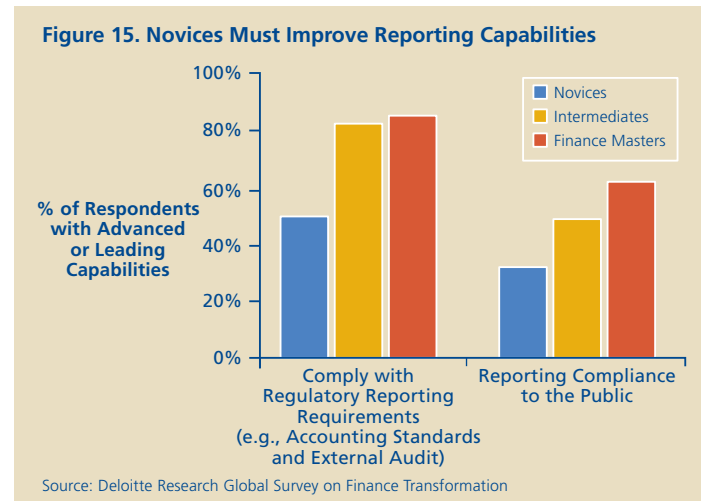
- Compliance
- Management reporting
- Forecasts and budgetary plans
- Financial policies, processes and procedures

Compliance

At its most basic level, the finance function must protect and preserve taxpayer assets and take the lead in complying with financial reporting and control requirements. This role may not be glamorous, but if it's not handled correctly, nothing else really matters.

Departments with advanced financial management capabilities comply with the reporting requirements and are able to readily receive unqualified audit opinions. These agencies are generally strong at reporting on the performance of their compliance efforts and other programs. However, the majority of Novices are still not at a leading or advanced level in this area (figure 15).

Figure 15. Novices Must Improve Reporting Capabilities



Management Reporting

The role of finance must go beyond complying with basic statutory regulatory requirements and preparing financial statements. Decision makers need tools to help them link costs to performance, identify opportunities to reduce direct and indirect costs, and increase efficiency in meeting policy objectives. This entails employing financial data to create high-level management dashboard reports that serve organizational leaders—dashboard reports that not only include information on expenditures versus plan and revenues versus plan, but also integrate financial and performance data to help public leaders identify trends and changes in their operating environment.

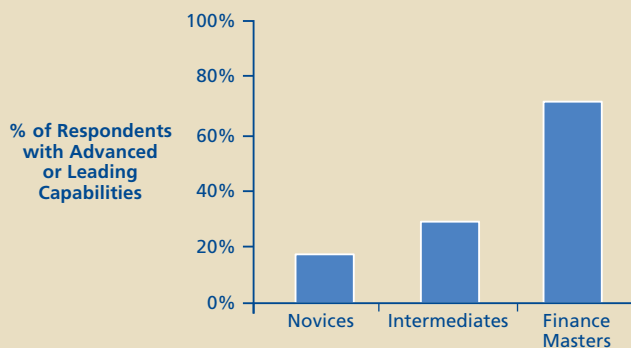
The U.S. Air Force Material Command, for example, revolutionized the management of its finances by making information on costs and outputs available to managers, who could then identify expenses and reduce them where appropriate. This effort helped the Air Force reduce its subsequent budget request by \$2.7 billion.¹⁰ Such savings would not have been possible without sound financial management reporting.

Our survey, however, shows that the management reporting currently in place tends to underserve government agencies. Only 28 percent of the Intermediates and 17 percent of the Novices are at an advanced or leading level in management reporting compared with 71 percent of Finance Masters (figure 16).

Enhancing Management Reporting at the United States Postal Service

An important step to becoming a finance master is upgrading the organization's financial management system. In 2000 the United States Postal Service (USPS) implemented an innovative agency-wide system called the Electronic Data Warehouse (EDW). This system gives officials access to accurate data, which helps them make the best short- and long-term strategic decisions. Managers across the organization can use this data to show the link between the activities of the organization and outcomes. EDW generates about 1,600 reports daily. It has evolved from being a repository of sales data to a resource for financial management and operational decision making. Reconciling the books for the roughly 37,000 financial units in the USPS used to take several months. With EDW, this exercise is now completed in hours.

Figure 16. Sophisticated Management Reporting Still Rare



Source: Deloitte Research Global Survey on Finance Transformation

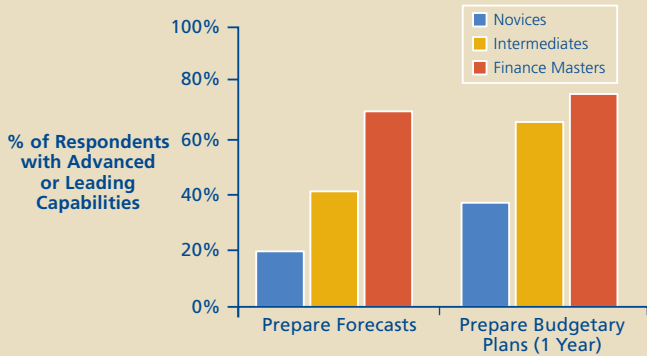
Forecasts and Budgetary Plans

Public sector organizations operate in a dynamic environment, and the services they provide change frequently. As a result, governments need not only to plan for current activities, but to view current operations in the context of future goals and future revenues. (See nearby inset on City of Napa Trend Monitoring System.)

Financial forecasting—the projecting of a government agency's revenues and expenditures into the future—is essential to help public officials evaluate the long-range economic effects of proposed initiatives.¹¹ The financial forecast for Kansas City, Missouri, for example, showed that while current operations were in balance with revenues, the “out years” told a different story. From 2008–09 to 2012–13, Kansas City's average revenues were forecast to grow at around 2.2 percent per year while the expenditures would grow by more than 5.4 percent, making the budget structurally imbalanced.¹² The city's financial forecasting helped officials better understand the business drivers behind the deficit, how long it is likely to last, and how much leeway they have to launch new programs.

Financial forecasts can then be converted into annual budgetary plans. Together, forecasts and budget plans can help public agencies make tough choices when allocating scarce resources. Unfortunately, many agencies struggle in this area (figure 17).

Figure 17. Finance Masters Possess Strong Forecasting Capabilities



Source: Deloitte Research Global Survey on Finance Transformation

Financial Policies, Processes, and Procedures

When operating well, financial policy helps to translate the mission of an organization into its operational processes and procedures. For example, to develop well-guided program policies, one must first understand the costs associated with those policies both now and in the future. Unfortunately, this tends to be one of the more pervasive gaps between finance best practices and actual capabilities.

In some jurisdictions governments use a cash accounting method as opposed to the accrual method so prevalent in the private sector. Cash accounting shows revenues as they come in and go out, but it does not show obligations accumulated in anticipation of revenues. For many programs, cash accounting provides either an incomplete picture or, even worse, a misleading picture of the financial condition of a program.¹³

Napa’s Trend Monitoring System

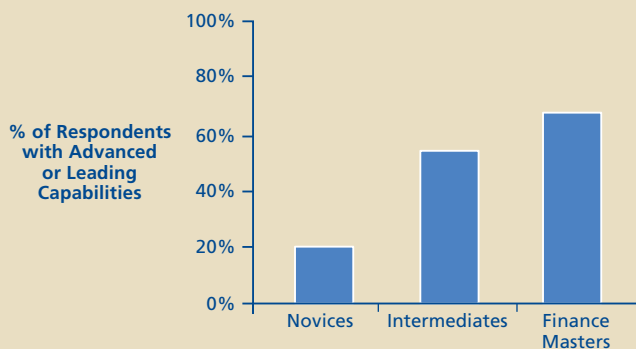
The city of Napa, California, prepared a long-term financial plan for the first time in 2007. Its objective was to identify “negative trends that can be addressed proactively to avoid serious long-term impacts.” The city has come up with a list of metrics that are marked favorable, unfavorable, warning, or caution, depending on the fiscal outlook.

| Metric | Favorable | Warning | Unfavorable | Caution |
|---------------------------------|-----------|---------|-------------|---------|
| Revenue trends | | | | |
| Revenue per capita | ● | | | |
| Property tax revenues | ● | | | |
| Sales tax revenues | ● | | | |
| Transient occupancy tax | ● | | | |
| Business license revenues | ● | | | |
| Vehicle license fee revenues | | | | |
| Elastic revenues | | | | |
| One-time revenues | ● | | | |
| Expenditure trends | | | | |
| Expenditure per capita | | ● | | |
| Authorized positions per capita | | ● | | |
| Fringe benefits | | | | |
| Salary expenditure | ● | | | |
| Capital outlay | | | | ● |
| Operating Trends | | | | |
| Operating position | | ● | | |
| Fund balance | | ● | | |
| Liquidity | ● | | | |
| Debt service | ● | | | |
| Additional Indicators | | | | |
| Assessed property value | ● | | | |
| Population | ● | | | |

Source: City of Napa, California

Viewing a program both on a cash basis and on an accrual basis that links current activities with assumed liabilities can give a more complete accounting picture and enable more accurate forecasting. Even for agencies involved in service activities, be they social services or transportation, accrued liabilities associated with future retirees (current workers) and other future liabilities should be factored into a complete picture of an organization's fiscal situation. This is another important aspect of the Steward/Operator capabilities that Novices need to improve (figure 18).

Figure 18. Novices Must Focus on Improving Financial Policies, Processes, and Procedures



Source: Deloitte Research Global Survey on Finance Transformation



Stage Two: Provide Strategic Insight

For those with solid core-financial-management capabilities, even if there is still room for improvement, the next step on the journey to finance mastery requires adding a new mix of capabilities. Often, that means introducing financial management activities that simply have not been done before.

Stage Two: Provide Strategic Insight

What government does

- Set strategic priorities
- Improve resource allocation
- Evaluate policy alternatives
- Set performance measures and targets

How government should do it

- Provide better value for money
- Protect value through improved risk management
- Support talent management

The biggest challenge for aspiring Strategists and Catalysts is that the skill sets required are different from those required for Stewards and Operators. Effective Strategists don't just understand the *numbers*, they deeply understand the *mission*. They don't just *follow* the rules; they help develop creative new approaches that *redefine* the rules. Responsive, accurate, and complete financial support is not sufficient for this level of value creation. Strategists and Catalysts must proactively seek out areas within the organization in which financial insight can benefit the mission.

To move up the curve to Finance Master, Intermediates must acquire a set of capabilities that help government agencies first determine what they should do and second, how they should operate. We start off by looking at the finance capabilities that can help governments improve their decision making around what they do. This encompasses determining the mission, developing a strategy to execute the mission, long-term planning, and setting standards and benchmarks for performance.

Enhance Decision Making around What Government Does

Set Strategic Priorities and Improve Resource Allocation

The right financial information can help shape realistic long-term plans, evaluate strategy, and define the outcomes expected from specific activities. Financially savvy decision makers and managers use financial information to support their judgments when planning. However, most agencies surveyed spend most of their time addressing short-term issues, do not fully understand the long-term cost implications of short-term decisions, and fail to adjust performance targets when circumstances change (figure 19).

This is a serious problem. An organization cannot perform well unless its leaders lay out clear strategies. To be meaningful, a strategy has to include not only changes to programmatic activities but also an assessment of future expected costs and outcomes. That sort of comprehensive strategic outlook can be very powerful in helping governments better allocate scarce resources. (See Ontario Health Care inset nearby.)

Unfortunately, many public sector organizations are not confident that their finance function is mature enough to determine strategic priorities, develop project cost-benefit analyses, and prioritize investments or to help them prioritize and gain approval for high-value initiatives. Fewer than 20

percent of Intermediates have strong capabilities on this very critical front. These gaps help explain why so many government agencies do not perform as well as they could and point to the need for improvement.

Assessing Trade-Offs Between Various Health Care Investments in Ontario

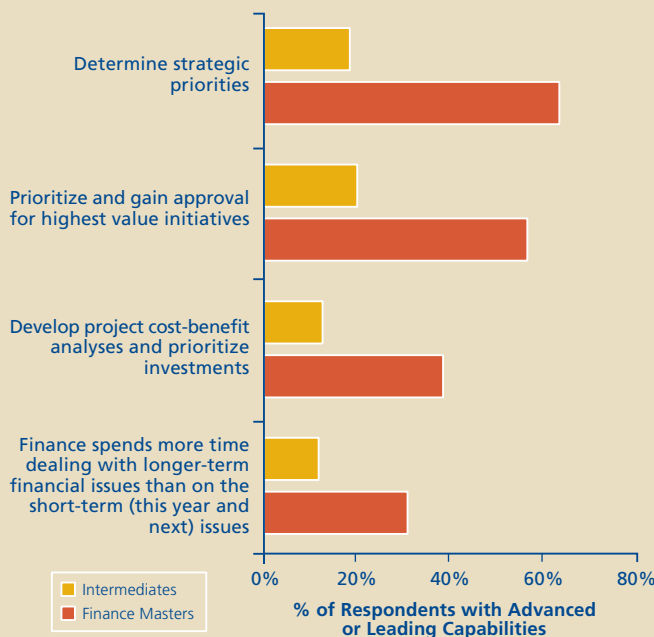
To produce results, decision makers need to understand how different parts of a system interact to generate value. It is impossible to set budget priorities without understanding how costs are linked to outcomes. In much of the developed world, the cost of health care is growing at an unsustainable rate. In the Province of Ontario, Canada, health care costs have risen by 8 percent on average over the past five years. If this rate continues, health care will consume the province's entire budget within the next two decades. Cutting expenses by reducing the level of service across the board is not a long-term option. The Ministry of Health and Long-Term Care in Ontario is now breaking new ground in the public sector by applying value-based management and portfolio management techniques to inform resource allocation decisions.

As a starting point, the ministry has defined its long-term strategic objectives, identified the health care outcomes it considers valuable, and started creating tools to determine the impact of every dollar spent. These are the first steps in a portfolio management approach, which requires assessing trade-offs between competing investments by defining what is important from a "value" and "risk" perspective. For example, when completed, these outcome-focused portfolio management techniques will allow the ministry to assess the trade-off between investing in prevention and health promotion activities and investing in productivity improvement initiatives, such as the development of electronic patient records.

At the heart of this new approach is the notion that the ministry is the steward of the system; the ministry's primary role is to set strategy, policy, and funding direction for the system as a whole. Delivery of health services will become the responsibility of Local Health Integration Networks that have been established on a regional basis across Ontario. The ministry has reorganized to better reflect those goals, creating divisions in charge of information, strategy, finance, and accountability and performance.

Source: Deloitte Research

Figure 19. Strategic Priorities, Value and Resource Allocation



Source: Deloitte Research Global Survey on Finance Transformation

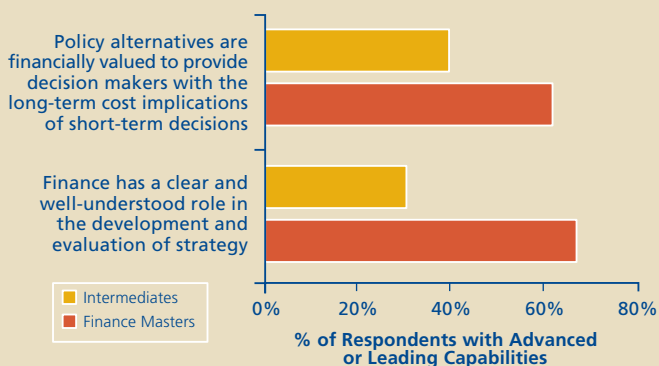
Evaluate Policy Alternatives

When policy-makers decide to require every citizen in the state to have health insurance, it means that the health department has to determine how best to meet—and finance—that mandate.¹⁴ Similarly when a government commits to a multi-billion-dollar infrastructure building program, policy makers need to understand which projects will give them the best bang for the buck.

Finance Masters help policy makers address policy design and execution challenges by accurately describing the funds, personnel, and structures needed to see a program from start to finish and to modify the program when circumstances require it. As new challenges arise, as new technologies come into play, and as new forms of revenue are created, the finance role becomes central to guiding the design and delivery of successful public programs and projects.

Our survey shows that only about 40 percent of Intermediates have leading or advanced capabilities in assessing the long-term financial implications of policy alternatives (figure 20). That means that in three out of five of these organizations, decision makers don't have a clear picture of the long-term cost implications of short-term decisions. Sixty-six percent of Finance Masters say they believe finance has an important role to play in developing and evaluating strategy, while only 30 percent of Intermediates believe the same.

Figure 20. Finance Masters Play a Key Role in Evaluating Policy Alternatives



Source: Deloitte Research Global Survey on Finance Transformation

Set Performance Measures and Targets

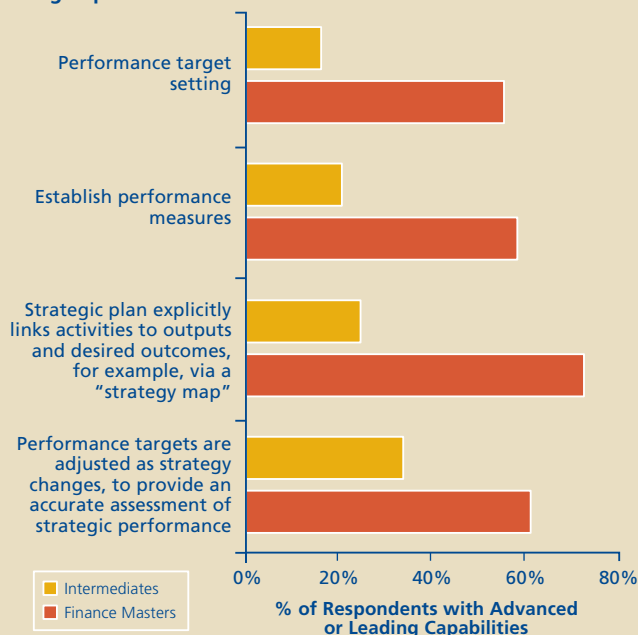
Finance Masters understand that financial and operational metrics and targets are not merely private sector concepts. To execute a strategy, one needs scorecards that are aligned to the strategy and that help evaluate the performance of the organization and its people. The organization should regularly review and revise these metrics to prevent deviation from the strategic intent. Budgets allocate resources, determine priorities, and drive policy changes. But governments did not start linking budget allocations to outputs and outcomes until fairly recently, and the process is still in infancy in many countries. Agencies and programs still often receive funding irrespective of their past performance and expected results.

However, the situation is changing fast. The Dutch Ministry of Finance introduced an initiative, called From Policy Budgeting to Policy Accounting, in 1999. When allocating funds to a program, the government no longer bases its decisions on money spent in the past, but on current policy and the goals it wants to achieve. This program has made the relation between policy, performance and funds central to both the government's budget and accounting documents. This means the accounting helps determine whether project performance is meeting benchmarks and budgeting is then adjusted according to those findings.

New Zealand started on a similar path in the mid-1990s. Australia and the United Kingdom also have developed a strong focus on outcomes. France and Japan are just starting to use performance measures to guide policies and budgets. The United States is using performance measures for policy development, budget allocations, and overall improvement in the management of federal government programs.¹⁵ For example, NASA has developed a process called Full-Cost Budgeting, which ties budget plans to performance.¹⁶

Few public agencies, however, excel at establishing metrics, setting targets, and keeping them aligned to the organization's strategy. Only about one-fifth of Intermediates report having strong capabilities in setting performance targets and establishing performance measurements. More than half of Finance Masters, in contrast, have strong capabilities in these areas.

Figure 21. Finance Masters Have Strong Performance Target Setting Capabilities



Source: Deloitte Research Global Survey on Finance Transformation

Improve How Government Operates

We have seen how Finance Masters can help government agencies evaluate what they do and how they measure their performance. Finance Masters play an equally important role in improving how government should operate to achieve these results. They do so in many ways, but here we highlight three attributes of leading financial management organizations that emerged from the survey results: provide better value for money; protect value through better risk management; and support HR through talent improvement.

Provide Better Value for Money

Most government agencies still have difficulty providing information to program managers on the full costs of the services they offer, including asset costs. Finance Masters do much better on this front than Intermediates, but our data show that even they still have substantial room for improvement (figure 22).

To be sure, governments face unique challenges in this area. Most government agencies do not exist to make a profit. They exist to help families in need, to protect the property and freedoms of their citizens, and to meet other public needs. Often the value of the outcomes delivered is much harder to measure financially than shareholder value in the private sector.

Setting and Implementing Performance Targets in the Netherlands

In 2002 Rijkswaterstaat (RWS), the operational unit of the Dutch Ministry of Transport, Public Works and Water Management, which is responsible for developing and managing the country's national infrastructure networks, began a much needed transformation. The beleaguered agency had been plagued by high headcounts, unrealized project targets, and cost and time overruns. Moreover each of its dozen regional departments all had their own stovepiped IT systems and processes. This caused inefficiencies and difficulties quickly accessing key financial data. To improve performance, RWS's governance structure was fundamentally overhauled. The new governance model was based on three pillars:

- 1. Steering on performance:** Maintenance and management activities are performed in accordance with defined Service Level Agreements (SLAs).
- 2. Steering on projects:** Based on the management of infrastructure projects.

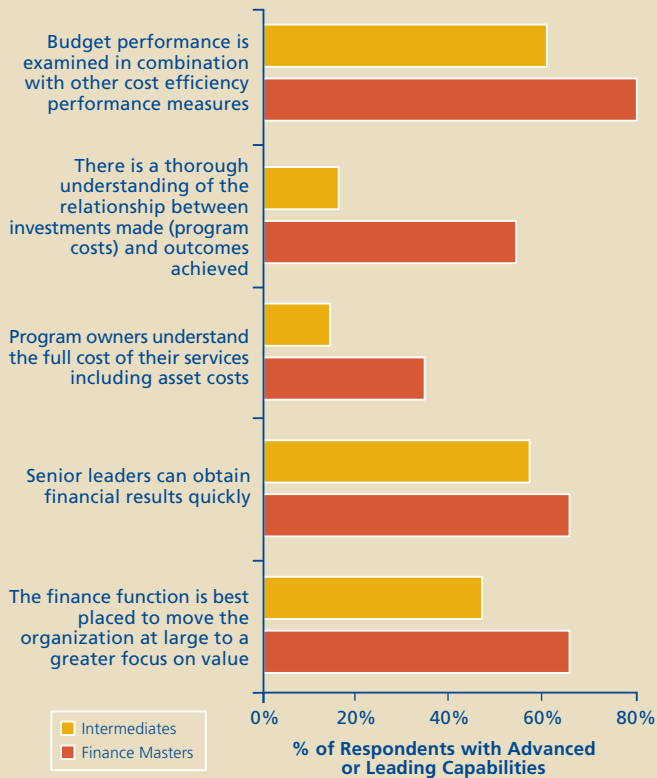
3. Steering on capacity: Based on the availability of key knowledge in the areas RWS is active.

The finance function was responsible for implementing this new governance model. This included supporting the development of strategic measurement, ensuring that financial steering was efficient, and putting in place the right control mechanisms.

In developing strategic measures, the finance function helped the operational departments determine what strategy to follow and how to define the metrics needed to measure success. After implementation, the finance function worked with the departments to track nonfinancial performance metrics. By analyzing the performance data and challenging the operational units to act on that analysis, finance also provided the operational departments with guidance on steps to improve their performance.

Source: Deloitte Research

Figure 22. Providing Value for Money



Source: Deloitte Research Global Survey on Finance Transformation

Nevertheless, when strong leadership is present, the ability to associate costs with outputs and outcomes produces several benefits. First, an organization that knows how much it costs to produce and deliver a specific outcome can ensure efficient service delivery through regular monitoring of cost and benefit indicators. Second, the organization knows how best to reallocate resources in response to changes in the environment. So, if a natural disaster or a dramatic shift in policy occurs, a finance function that keeps a regular tab on performance and costing data will know what resources can be shifted where with the most effect and least cost. (This is similar to what central banks do. They keep monthly, weekly, and now even daily records of the indicators so that a possibly bad situation is detected early, and they understand what their alternatives are.) Third, the organization can use its knowledge of costs and benefits to speed up the decision-making process, giving the organization greater flexibility. Finally, the organization can use this information to support more accurate budgeting in the future and to justify demand for additional resources.

Finance and Better Operational Decision-Making: The Case of Military Logistics

When nations deploy to war in faraway places, one of the things they need to figure out is the amount of supplies and gear to take over with them at the onset versus what will be shipped later based on need. The obvious advantage to taking over as much as possible at the beginning is that you are less likely to run out of supplies. The disadvantage is that, between storage and logistics costs, it is extraordinarily costly to go to war this way. Moreover, if the conflict ends earlier than envisioned, the deployed unit is left with a lot of wasted supplies. How do you determine the optimal amount of supplies to bring to the warfront? This is a job for the finance function.

Consider two army divisions about to deploy overseas. One commander has a light division. Her philosophy is that she wants to bring only exactly what she needs so she can be more mobile and responsive. The other commander has an armor-heavy division, replete with many months' worth of bottled water and all the bells and whistles that are logistically possible to deploy. His reasoning seems equally rational: he wants to be prepared for any contingency and certainly doesn't want to run out of supplies during a war.

What role would a best-in-class army finance function play toward resolving the issue? Ideally it has collected enough data from previous engagements to have the predictive capability to estimate the optimal amount of supplies from a cost and logistical perspective to bring over on the initial deployment. This knowledge would be imparted to each of the commanders, to heavily inform both their requests and what is ultimately approved. To have such a capacity, however, the finance function needs to have exceptionally good data. This in turn requires a strong cost accounting system, something many governments do not today possess.

Protect Value through Better Risk Management

For the typical government organization, managing risks and assessing vulnerabilities involves everything from managing contracts and grants to protecting information systems and data from theft or destruction. Another way the government finance function helps to better manage risk is by ensuring that funds invested in government projects do not go to waste through mismanagement. It does this by identifying potential risks, taking steps to preempt those risks, and developing pathways to get out of a crisis when it occurs.

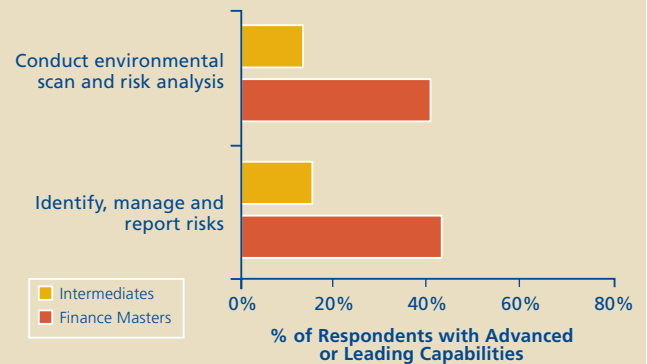
Effective risk management also entails the ability to anticipate and prepare for potential risks. Consider the U.S. Social Security Administration (SSA). The aftermath of Hurricane Katrina posed an enormous challenge for government agencies seeking to aid the Gulf Coast region. The SSA stood out as a bright spot in a chaotic environment. When Katrina destroyed most of the SSA's regional offices, officials rerouted resources so they could meet the demand for replacement Social Security cards, without which many Katrina victims could not apply for jobs or open new bank accounts. In this



environment, management information was critical. The SSA had precise workload measurements and case data that it used to anticipate demand for services in the regions affected by the hurricane. In addition, because it had a flexible financial system that went beyond transactional processing, the SSA was able to readily switch to alternative methods for disbursing funds. For example, it distributed money to hurricane victims in the form of debit-like cards so they could receive Social Security payments without having to visit banks. In short, SSA had the financial tools it needed to contend with a major organizational challenge.

Unfortunately, this example is more rare than typical in the public sector. Overall, most Intermediates indicate weak risk management capability. More than 40 percent of Finance Masters have strong risk management capacities, compared with less than 15 percent of Intermediates (figure 23).

Figure 23. Risk Management Capabilities Still Emergent



Source: Deloitte Research Global Survey on Finance Transformation

Support Talent Management

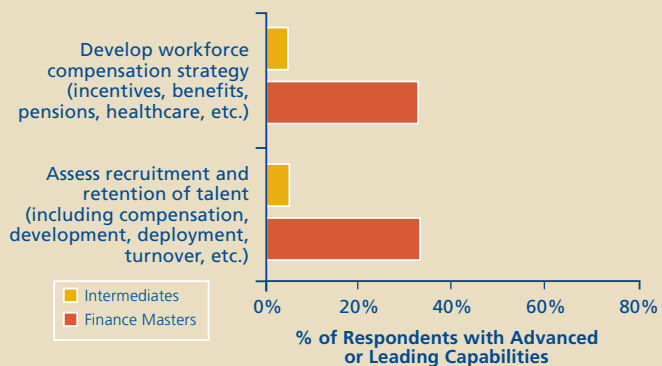
Public organizations, like their private sector counterparts, are engaged in a war for talent, particularly acute for financial- and technology-oriented professionals. Typically, personnel costs represent the lion's share of public budgets. Agencies must also keep from losing institutional knowledge as aging baby boomers retire.

In recent years, governments around the globe have had a difficult time recruiting and keeping skilled professionals, especially in the areas of finance and information technology. Public agencies can benefit by attracting new talent from the private sector, particularly when they are in need of new skills—such as the skills associated with financial transformation, including strategy formulation, performance measurement, and accrual accounting. Unfortunately, cumbersome hiring processes, outdated promotion policies, and inflexible rules that fail to compensate for specialized skills are just a few of the obstacles to attracting and retaining the most qualified employees.



A sophisticated finance group can help manage talent. By providing insights into the costs of the workforce, including recruitment and training costs, finance can assist management in setting effective compensation policies. About one-third of the Finance Masters have strong capabilities in developing workforce compensation and in assessing, recruiting, and retaining talent (figure 24). By comparison, less than 4 percent of Intermediates have developed strong foundations in supporting human resources.

Figure 24. Capabilities to Support Talent Management Weak Across the Board



Source: Deloitte Research Global Survey on Finance Transformation

Overcoming Implementation Challenges

So far, we've looked at the characteristics of Finance Masters—what it is that world-class public sector organizations do that their less accomplished peers do not. We've reviewed a number of specific activities that distinguish financial leaders from the rest, and we've looked at the typical path from a Novice to an Intermediate to a Finance Master. We've looked at the route to financial excellence, as well as at some of the benefits that come from reaching the promised land of financial mastery.

Taken together, the changes mark the path of what we call “financial transformation.” We define financial transformation as the advancement of the financial function from one that focuses primarily on Steward or Operator tasks (done well or done poorly) to one that also performs well around activities in the Strategist and Catalyst areas.

Such a transformation is not easy, and it may require several years. For agencies of limited size operating in a largely static environment, such a transformation may be neither realistic nor desirable. For an increasing number of public operations, however, financial transformation is essential to effectively serve the public in a dynamic and complex environment. A chief financial officer of a public agency must ask whether a financial transformation is needed to enable an agency to reach a new level of mission fulfillment. Often, the answer will be a resounding yes.

It is one thing to have a picture of the road ahead, however, and quite another to travel it. Many government organizations have attempted to make the transition from the traditional Steward and Operator roles to Strategist and Catalyst. Some have succeeded, others have not.

Several common themes characterize failed finance transformation efforts in government agencies. Many agencies attempt to implement new financial systems without developing a clear vision of how these tools and practices will help advance their mission and what organization and business process are necessary to get there. Others cannot afford the investment in the requisite technology, or they do not secure the support from enough internal stakeholders to institutionalize change. To justify the resources needed, financial transformation requires demonstrating a return on investment to the organization as a whole.

The Finance Masters have figured out how to navigate these obstacles to successful implementation. They do so by following these strategies:

Build strong leadership

Implementing finance transformation requires a high level of commitment across the organization. Ultimately, finance transformation must be justified in light of the mission of the organization. Strong commitment from all levels of the organization depends on a rational long-term vision that lets employees know how each new product or task supports mission delivery. Agency employees must understand not only that financial transformation is a high priority, but also that they can benefit from embracing new skills and, in some cases, additional work.

Leaders often give lip service to the importance of transformation, but too few are willing to make the tough decisions required to adjust priorities among competing projects or initiatives, or to go to the mat with other parts of the organization, such as human resources or IT, whose commitments are often also needed to support finance transformation. Ultimately, a failure to allocate adequate resources for transformation initiatives signals to the entire organization that finance transformation is not a high priority for management.¹⁷

Even with high commitment, agencies still face organizational challenges because financial transformation can alter daily operations and responsibilities, and many employees may resist taking on unfamiliar roles. This is especially likely when employees do not see the value in the additional work that transformation requires.

Foster critical skills

Many public sector agencies suffer from a dearth of finance talent. More than 60 percent of the survey respondents said they find it difficult to attract qualified and experienced financial professionals.

The managerial workforce should be molded to support the financial management process. Organizations that want to build sophisticated finance functions must do two things: attract new talent and invest in the current workforce (see nearby inset). An organization's leadership must invest time and resources to identify gaps in employees' critical skills, and then it must develop training programs to address those gaps. Agencies can offer training through classroom instruction, planned staff rotations, interagency assignments, career development programs, and continuing education programs. Training has the added benefit of increasing retention among mid-career employees.¹⁸

The U.S. Air Force provides an excellent example: A "decision support course" is offered to instill those skill sets that make employees more proficient at financial management, budgeting, and cost and economic analysis.¹⁹ The course allows everyone from a base comptroller to a four-star commander to the Air Force secretary to use financial management systems in his or her daily work. When an agency builds a workforce that is fluent in the language of financial management, it also builds a workforce invested in the process.

Fostering Critical Skills

Strategies

- **Bend the Curve.** Governments need to evaluate the future demand for skilled finance professionals against the likely supply and aim to bend the supply and demand curves toward each other.
- **Fast-track Critical Talent.** Once critical talent has been successfully hired, organizations must work to ensure that top finance talent is on a fast track, with increasing responsibility and opportunities for professional development. By fast-tracking top talent, governments can address finance skills gaps in succession planning and capability transfer.
- **Utilize a "Develop-Deploy-Connect" Model.** This model represents an integrated management strategy in which employees receive relevant experience and guidance, are aligned in the appropriate position for their skills and interests, and develop the proper connections to advance within the organization.



Source: "Bolstering Human Capital," Deloitte Research, 2007.

Action Steps

- **Modernize outdated hiring practices.** Organizations can update hiring practices so that the process is both more efficient and speedy. In 2003 the San Jose Employment Services Department (ESD) adopted a decentralized, position-based hiring process, contributing to a reduction in hiring time from an average of 130 days to just 68 days.
- **Identify and target critical workforce segments.** Organizations should determine segments within the finance function that contribute disproportionately to the success of their organizations. These groups should be targeted through campus recruiting initiatives, outreach programs, and internships. They should also be targeted through specific retention programs. Under the U.S. federal government's IT Workforce Initiative, for example, IT specialists are eligible for retention allowances, which are paid at the rate of 5, 10, or 15 percent, depending on the educational degrees and certifications earned by the employee.
- **Adopt innovative recruiting strategies.** To change the perception of the public sector, governments must undertake marketing and educational efforts as part of their recruiting practices. Government organizations should develop relationships with local graduate programs and offer competitive, Gen Y-tailored employment packages.
- **Upgrade technology.** Process automation and self-service e-government solutions increase productivity and reduce demand for labor.

Split, pace, and pilot finance projects

Finance transformation projects tend to be very large and extend over a lengthy period of time, often measured in years, increasing the risk that they will fail. And because such large projects can have a significant impact on the core business, failure can bring real disaster. This risk should not only be reduced, but be spread out to the business units on whose behalf these projects are initiated. One way to manage risk is to split, pace, and pilot finance projects. This tactic can not only build momentum but also help garner broader external support for the project.

An agency implementing a new Enterprise Resource Planning system, for example, could *split* the project into smaller components, each with a clear and obvious benefit at the end. In Florida, the state's Department of Revenue faced a challenge in that 36 of its statutory taxes were administered in over two dozen rapidly aging, custom-developed systems. Another custom solution would be obsolete before it was complete and would thus fail to achieve the department's long-term objectives. As a result, the agency embarked on a six-year initiative to integrate all of the taxes into a single, unified tax application based on commercial off-the-shelf Enterprise Resource Planning software. By executing the initiative in a phased manner, the department minimized delivery risk while capturing the resulting benefits and efficiencies of a technology upgrade for those taxes that came on-line earlier in the project's life-cycle.

Implementation of the project should also be paced. Spreading the duration of the project and its funding, across several months or years (depending on the nature of the project) will increase the chance of completing the project successfully. That in turn will enhance the finance organization's reputation and encourage other units in the organizations to launch similar initiatives. When USPS consolidated its 85 district accounting offices into three accounting service centers in 2003,

management quickly switched from one system to the next. That forced the organization to deal speedily with a number of problems, such as the complexity of reassigning employees from the 85 district offices to the three centers, and the unavailability of accounting data during the transition period. A senior USPS official points out that the journey would have been smoother had the organization experienced a phasing-out process rather than the closure of all the district offices at once.

Lastly, the USPS experience points to the importance of first piloting the initiative locally in order to better evaluate effectiveness, return on investment, and the risk involved in full implementation. In this case, USPS might have benefited from a phased implementation with a pilot in one or two locations initially.



Conclusion

This study, based on survey data covering more than 200 public sector organizations at the national, state or provincial, and local levels of government, has demonstrated how financial transformation can bolster the public sector's ability to achieve its mission if managers can successfully integrate the transformed finance organization into agency operations. By adopting a set of more sophisticated capabilities, Finance Masters are not only transforming the government finance function itself but also playing a lead role in improving the business of government—both in helping government leaders make more strategic decisions about how to spend scarce resources and measure results and in showing how government should operate to achieve these goals.

As we have shown, there is a clear progression from one stage of financial management to the next. Agencies at the Steward level can typically do transactional accounting, but the focus tends to be short-term and around discrete functions. To become effective Operators, they need to expand their capabilities for managing financial data, undertake qualitative as well as quantitative analyses, and begin to focus on the mission of the entire enterprise. To become strong and effective Strategists, Operators must use financial tools to assess strategic decisions, work toward integrating

management processes, operations, and data management systems, and build a skilled staff with strategic and operational skills. Strategists become Catalysts—and Finance Masters—when they put all this together and use financial data and intelligence to support policy execution and operations across the government enterprise.

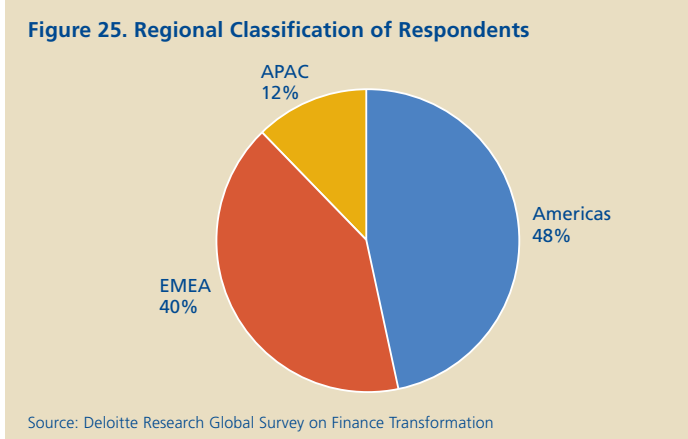
The first step, though, for any agency not already a Finance Master is to assess where it is currently—its strengths and weaknesses—and then determine how to remove the weaknesses.* That process alone will set most agencies on the strategic path toward financial transformation.



* Contact William D. Eggers at weggere@deloitte.com if you are interested in participating in our research project and benchmarking your current capabilities against peer organizations and Finance Masters.

Appendix A: Methodology and Respondent Profile

This study is based in part on the ongoing Deloitte Global Survey on Transforming the Enterprise through Finance, with more than 200 government organizations participating to date across the Americas, Asia Pacific (APAC), and Europe, the Middle East, and Africa (EMEA). Countries participating in the study include Argentina, Australia, Austria, Belgium, Bosnia and Herzegovina, Canada, Cyprus, Denmark, Finland, Germany, India, Ireland, Jordan, Mexico, the Netherlands, New Zealand, Norway, Panama, Peru, Poland, Montenegro, Slovakia, Spain, Sweden, United Arab Emirates, United Kingdom, United States, and Uruguay (figure 25).



Sixty-three percent of respondents have annual department, division, or unit budgets of less than US\$100 million. For about 35 percent of the respondents, the government agency's annual budget is in the US\$10 million-50 million range.

About half of the participating organizations are at the national level of government, and 23 percent are at the state or provincial level. The remaining respondents are spread between government at the municipal level, officials associated with public universities, hospitals, school boards, and the like. The largest distinct group of respondents work in the defense sector (11 percent), followed by transportation (10 percent), and education (9 percent). The category "other," which comprises 39 percent of all respondents, includes government organizations from a variety of areas such as tourism, labor, finance, human resources, treasury, research and development, telecommunications, homeland security, space, postal, immigration, and audit. (figure 26.)

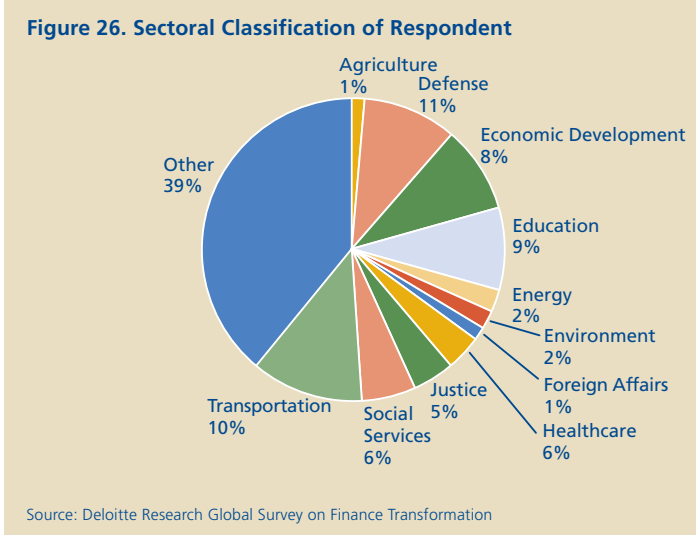


Figure 27 depicts the finance capability maturity model scale used in this study to rate organizations based on their survey responses. Organizations were rated on a scale of 1 to 5, with respondents above 3 having strong capabilities and those below 3 having significant scope for improvement.

Figure 27. Scale for Financial Capability Maturity Model

| Finance Capability Maturity Level | Description |
|-----------------------------------|--|
| 5: Leading | Leading practices thoroughly embedded in processes and tools. Integration of internal and external data to support processes. Real-time information. |
| 4: Advanced | Leading practices introduced. Enterprise integration of processes and internal data. Widespread automation. |
| 3: Baseline | Standardized process. Some integration across the enterprise. Moderate amount of manual effort. |
| 2: Developing | Process capability partially defined. Different approaches used in the organization. |
| 1: Non-existent | Capability not in place in any structured sense. |

Source: Deloitte Research Global Survey on Finance Transformation

Appendix B: Finance Transformation Taxonomy

| Faces of Finance | Capabilities |
|------------------|---|
| Steward | <ul style="list-style-type: none"> • Prepare forecasts • Comply with regulatory reporting requirements (such as accounting standards and external audit) • Report compliance/program performance to the public • Certify financial statement controls • Prepare audited departmental financial statements • Develop and maintain financial policies, processes, and procedures • Perform internal audits • Develop standardized approach to costing • Define management reporting requirements • Prepare budgetary plans (one year) • Identify, manage, and report risks |
| Operator | <ul style="list-style-type: none"> • Prepare cost-of-service reports • Use accrual based accounting • Engage in capital asset planning • Manage and control pension liability • Manage and control employee benefits • Manage finance talent (recruit, retain, develop, deploy) • Manage capital investment budgets for IT infrastructure • Manage the finance organization • Perform transaction processing • Perform cost accounting • Manage cash transactions from operations |
| Strategist | <ul style="list-style-type: none"> • Link financial issues to strategy • Financially value policy alternatives with long-term cost implications • Conduct environmental scan and risk analysis • Determine strategic priorities • Develop project cost-benefit analyses and prioritize investments • Prioritize and gain approval for highest-value initiatives • Establish performance measurements |
| Catalyst | <ul style="list-style-type: none"> • Support business analysis • Set performance targets • Cascade performance targets down through the organization • Benchmark service and channel costs to external providers • Assess recruitment and retention of talent • Develop workforce compensation strategy • Support compensation planning • Negotiate and manage external contracts and service agreements for IT • Analyze and optimize long-term capital assets (tangible assets) • Optimize program and service delivery • Measure customer cost to serve |

Endnotes

- ¹ A series of laws has been passed in the United States to hasten the adoption of financial reforms in government. The Chief Financial Officer (CFO) Act of 1990 standardized processes and created a leadership structure to support a shift from short-term to long-term planning, enhanced agency accountability, and integrated financial management systems. More recently, the President's Management Agenda of 2001 introduced "critical success factors" to improve individual and collective financial performance of agencies through the CFO council.
- ² National Academy of Public Administration (NAPA), "Moving from Scorekeeper to Strategic Partner: Improving Financial Management in the Federal Government," Washington, DC, October 2006.
- ³ Organization for Economic Co-operation and Development (OECD), "Ageing and Pension Reform: Implications for Financial Markets and Economic Policies," Volume 2005; Supplement 1, November 2005.
- ⁴ Jack Welch, "Public-Private Partnerships in Germany: German Budget Deficits Present Investment Opportunities," *Infrastructure Journal*, Spring 2006. <<http://www.ijonline.com/pdf/2006springIJ/10PPPsInGermany.pdf>>.
- ⁵ Dennis Cauchon, "Huge Bill for Public Retirees Hits Soon," *USA Today*, May 18, 2006 <http://www.usatoday.com/news/health/2006-05-18-retiree-health_x.htm>.
- ⁶ The White House, <<http://www.whitehouse.gov/news/releases/2006/09/20060926.html>> accessed December 19, 2007.
- ⁷ A baseline capability implies that there is some integration across the enterprise and standardized processes exist, though a moderate amount of manual effort may be involved in carrying out these processes.
- ⁸ See, for example, Deloitte Touche Tohmatsu and Economist Intelligence Unit, "The Finance Talent Challenge: How Leading CFOs Are Taking Charge," New York, 2007.
- ⁹ For a review, see Jeremy Hope, *Reinventing the CFO: How Financial Managers Can Transform Their Roles and Add Greater Value* (Boston, MA: Harvard Business School Press, 2006).
- ¹⁰ Michael Barzelay and Fred Thompson, "Efficiency Counts: Developing the Capacity to Manage Costs at Air Force Material Command," Financial Management Series, IBM Center for the Business of Government, Washington, DC, August 2003.
- ¹¹ Christopher Swanson, "Time Is Always Money," *American City & County*, October 1, 2007 <http://americacityandcounty.com/administration/money_forecasts_local_gov/> accessed December 10, 2007.
- ¹² Finance & Audit Committee, Kansas City, "Five Year Financial Forecast," <<http://www.kcmo.org/manager/omb/2009-13-financialforecast.pdf>>, accessed January 29, 2008.
- ¹³ Particularly for agencies whose mission involves the disbursement of funds to eligible parties who have earned those benefits in the past, the cash method is incomplete. Programs such as government-provided retiree benefits or other entitlements that have been earned in the past are generating, in effect, off-the-book accounts payable that will, with a high level of predictability, come due.
- ¹⁴ Jennifer Steinhauer, "California Plan for Health Care Would Cover All," the *New York Times*, January 9, 2007, <<http://www.nytimes.com/2007/01/09/us/09calif.html?hp&ex=1168405200&en=bc1e20fac914b0f6&ei=5094&partner=homepage>>, accessed December 27, 2007.
- ¹⁵ Office of Management and Budget, "Analytical Perspectives," Budget of the United States Government, Fiscal year 2003 <<http://www.gpoaccess.gov/usbudget/fy03/pdf/spec.pdf>>.
- ¹⁶ NASA, "Full Cost Budgeting," 2004 <http://www.nasa.gov/pdf/1964main_fullcost.pdf>.
- ¹⁷ Ernie Gregory, interview with the author, May 23, 2007.
- ¹⁸ General Accounting Office, "Executive Guide: Creating Value Through World-class Financial Management," GAO/AIMD-00-134, Washington, DC, April 2000.
- ¹⁹ John Vonglis, transcript from "The Business of Government Radio Show," originally broadcast September 13, 2006. <http://www.businessofgovernment.org/main/interviews/bios/john_vonglis_frt.asp>.

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