

2005
CFO SURVEY

PERFORMANCE MANAGEMENT
INTERNAL CONTROL

WITH

PERFORMANCE
MANAGEMENT



ABOUT THE ASSOCIATION OF GOVERNMENT ACCOUNTANTS

The Association of Government Accountants (AGA) was founded in 1950 and is the educational organization dedicated to the enhancement of public financial management. AGA serves the professional interests of state, local and federal financial managers who are responsible for effectively using billions of dollars and other monetary resources every day. AGA has been instrumental in developing accounting and auditing standards and in generating new concepts for the effective organization and administration of financial management functions. AGA conducts independent research and analysis of all aspects of government financial management. These studies—including the 2005 AGA CFO Survey—make AGA a leading advocate for improving the quality and effectiveness of government fiscal administration and program performance and accountability. For more information, please visit our Web site at www.agacgfm.org.

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In partnership with AGA, Grant Thornton was privileged to carry out the 2005 AGA CFO survey. Grant Thornton LLP, founded in Chicago in 1924, is the U.S. member firm of Grant Thornton International (www.gti.org), one of the six global accounting, tax and business advisory organizations. In 540 offices in 109 countries, including 49 offices in the United States, the partners of Grant Thornton member firms provide personalized attention and the highest quality service to public and private clients around the globe.

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EXECUTIVE SUMMARY

Since the enactment of the Chief Financial Officers Act of 1990 (CFO Act), the federal CFO community and its oversight organizations have developed performance measures for nearly every aspect of administering government. In addition, federal agencies are starting to appreciate the appropriate application of internal control to operations. The time has come to set priorities for integrating and applying both measures and controls to create high performance agencies and departments.

The Association of Government Accountants, in partnership with Grant Thornton LLP, sponsored a survey of senior financial executives in the federal government (the CFO community) between November 2004 and April 2005. The interviews focused on three issues: performance of financial functions, internal control and integrating performance measures.

WHAT THE CFO COMMUNITY MEASURES

When asked how they gauge the performance of their financial functions, respondents most often mentioned the following:

- Results of financial statement audits
- Customer feedback
- Timeliness in transactions
- Measures in the scorecard for the President's Management Agenda

Concerning the support customers want from the CFO community, financial executives tend to think of data, compliance, transactions and financial reporting. However, executive customers of financial functions give higher priority to more sophisticated support in areas such as cost/benefit and other analysis involving finance, planning and advocacy with the Office of Management and Budget (OMB) and the Congress.

Most respondents were positive about the President's Management Agenda, but many felt it was too "one size fits all" and does not help individual agencies to focus on their missions.

INTERNAL CONTROL

Internal control should be more about delivering on an agency's mission and less about simply complying with regulations. In the wake of private sector financial scandals, internal control is receiving increased attention in the public sector. Many respondents applaud this attention and the related new requirements for federal agencies set forth in 2004 in OMB Circular A-123, *Management's Responsibility for Internal Control*.

One reason is that many believe internal control in the federal government has become too much of a paper exercise. The new rules motivate CFOs to improve controls, give them leverage to make needed changes and invite them to become more involved in program improvements.

A few respondents had neutral or negative reactions to the 2004 revisions of OMB Circular A-123. For example, one respondent said the circular has minimal impact on his organization, which was "already headed in that direction." Another said the new requirements "are not rigorous enough."

INTEGRATED MEASURES AND INTERNAL CONTROL

Many respondents reported their agencies are tying performance measures to strategic plans, goals and objectives and five-year plans. Fewer managed to link measures to budgets, but those that did often had integrated measures to strategy beforehand. One respondent said that the key to this is to "have measures that fit the overall mission of the agency or program, instead of microscopic measures imposed by outside oversight organizations on low-level budgeting." According to many survey respondents, stronger Congressional support for performance-based budgeting would help speed the integration of measures.

Few agencies are trying to link the requirements of the 2004 revisions of OMB Circular A-123 to improved performance management. Those that have made the effort say it is worth the exertion. Tying controls to strategic objectives greatly improves the value proposition of internal control and shows top leaders the value of this aspect of sound management.

Federal agencies and departments now have the components needed to build effective performance management approaches. Going forward, federal agencies and departments, as well as oversight organizations, would do well to focus on setting priorities for those approaches. If not, then sorely needed resources may be spent on scattershot attempts to comply with government performance management regulations.

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ABOUT THE SURVEY

The Association of Government Accountants (AGA), in partnership with Grant Thornton LLP, has sponsored an annual federal chief financial officers (CFO) survey since 1996. Together, we design these surveys to:

- Identify emerging issues
- Provide a forum for candid exchange among government CFOs
- Promote communication within the federal financial management community
- Maintain AGA's leadership in governmental financial management issues

ANONYMITY

AGA's annual surveys of the CFO community do not attribute thoughts and quotations to individual financial executives who were interviewed. This preserves anonymity and encourages respondents to speak freely. Anonymity is particularly important when a respondent's opinions and thoughts are contrary to official policy.

SURVEY METHODOLOGY

Our 2005 survey focused on three timely and related issues of concern to the federal CFO community:

- Measuring the performance of financial functions
- Stewardship and internal control
- Integrating performance measures, financial measures and controls

In addition, we asked the question, What are the most pressing concerns of the CFO community? This particular question has become a regular feature of our surveys.

Grant Thornton, with the guidance of senior members of the AGA, developed the survey instrument. Our report reflects the views of the respondents to the extent possible, given the use of an open-ended questionnaire and the range of issues raised and discussed during interviews.

Partners and staff from Grant Thornton's Global Public Sector, on behalf of the AGA, surveyed 100+ members of the federal CFO community and their customers between November 2004 and April 2005. The federal CFO community included CFOs, deputy CFOs, other departmental and agency financial executives and leaders from oversight organizations. The customers were executives and senior managers who use information and services provided by the CFO community.

In three meetings held between December 2004 and April 2005, senior members of AGA and representatives of the federal CFO community provided leadership and guidance for the project. During the survey, the group discussed interim results; we include their input in this report.

BACKGROUND: PRESSURES AND PRIORITIES



In 2005, federal financial executives are feeling increased pressure to comply with a myriad of requirements and initiatives coming from oversight organizations, Congress and the public. The stress of compliance, say many survey respondents, would be greatly relieved if the government would set priorities for what it expects from the CFO community.

**WORKING IN THIS ENVIRONMENT
REQUIRES THAT THE ORGANIZATIONS
RESPONSIBLE FOR THE PRESSURE START
SETTING PRIORITIES ON WHAT THEY
THINK IS BEST FOR THE GOVERNMENT.**

The pressures include new requirements to collect and report a set of performance measures developed by the federal Chief Financial Officer's Council and a revised Office of Management and Budget (OMB) Circular A-123, *Management's Responsibility for Internal Control*. They include annual audited financial statements, the President's Management Agenda, the Government Performance and Results Act and other initiatives mandating new performance measurement. The graphic figure on the next page (Figure 1) illustrates the source of the pressure, which exerts itself on three areas: mission, enablers and stewardship.

The pressure indicated in the figure is a key component of the federal financial management environment and provides a context for the results of our 2005 survey.

Readers should keep in mind that working in this environment requires that the organizations responsible for the pressure start setting priorities on what they think is best for the government. As many of our 2005 interviewees indicate, trying to do everything required of them is consuming the resources needed to do the most important things right.



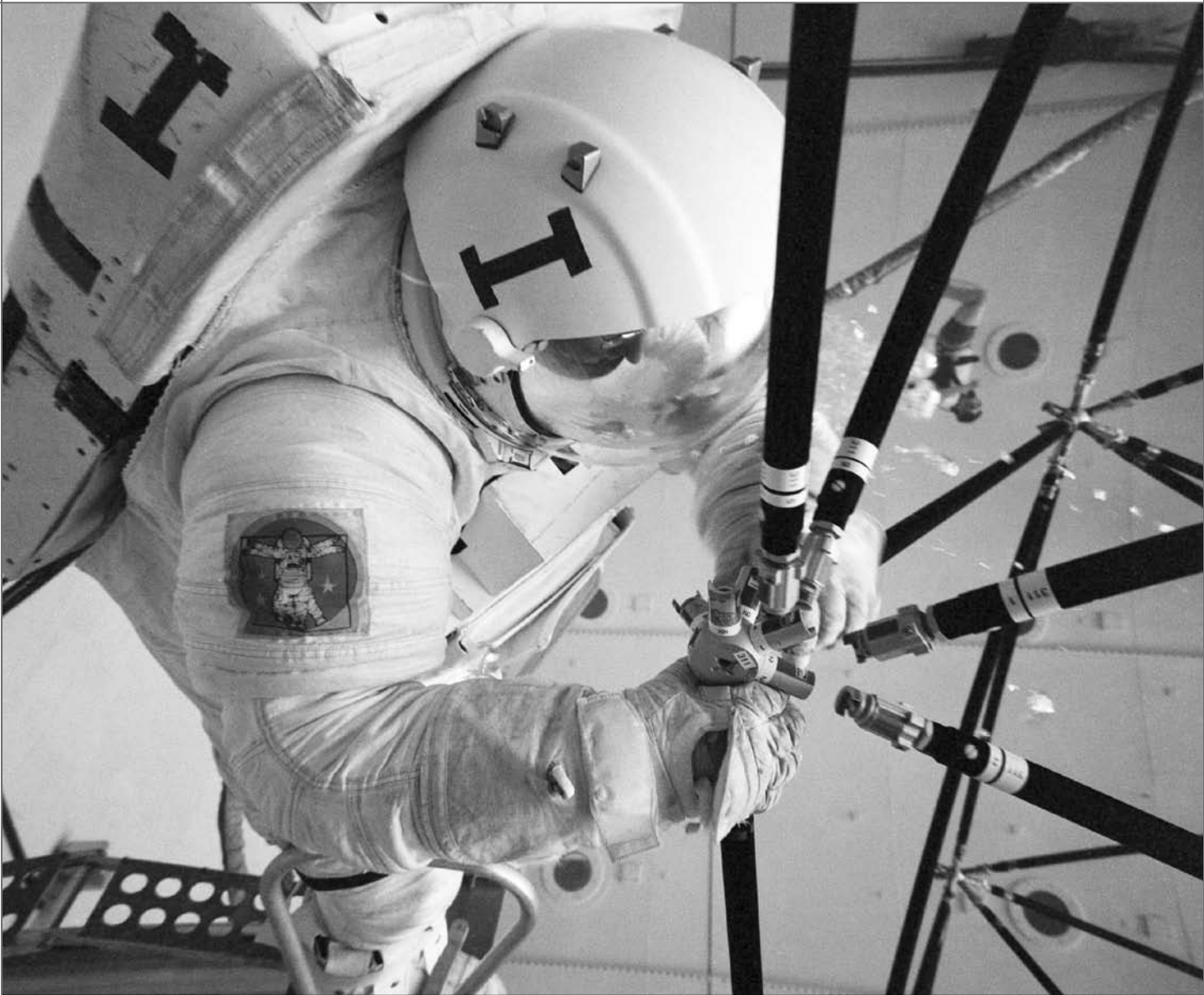
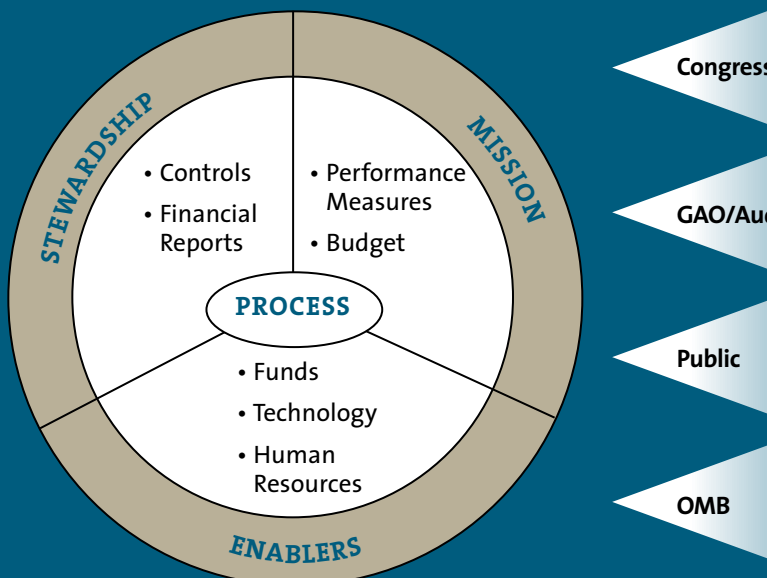


FIGURE 1: FORCES EFFECTING FEDERAL FINANCIAL FUNCTIONS



MEASURING FINANCIAL MANAGEMENT PERFORMANCE



How the federal government judges its financial performance is still a work in process even 15 years after the passing of the Chief Financial Officers Act of 1990 (CFO Act). Over the years, oversight organizations and Congress have been prolific in mandating financial and other performance measures.

In this section we discuss what the CFO community says it is measuring, what its customers measure and what the CFO community's reactions are to recent measurement initiatives, including the President's Management Agenda and the CFO Council's initial set of financial metrics.

WHAT THE CFO COMMUNITY MEASURES

When asked how they gauge the performance of their financial functions, survey respondents who are part of the CFO community most often mentioned these measures and measurement methods:

- Results of financial statement audits
- Customer feedback
- Timeliness in transactions
- President's Management Agenda

Results of financial statement audits

Several respondents to our survey said users of their financial data, including Congressional decision makers, value the credibility that clean or unqualified financial statement auditor opinions add to the information. As such, a clean opinion is a measure of success. Most large federal entities, including departments, large agencies and revolving funds, have been required to submit annual financial statement reports for audit since the passage of the CFO Act.

Almost all CFO Act entities received unqualified or clean opinions from auditors on their FY 2004 financial reports. Indeed, several respondents said that getting a clean opinion is now the expected outcome of an audit, so much so that getting a clean opinion has lost value

compared to other financial function performance indicators (but, some respondents mentioned, if a qualified opinion or disclaimer is given, then "heads will fly"). Many of these respondents felt that the cost of obtaining a clean opinion was too high and that oversight organizations put too much emphasis on financial statement report results.

Some felt that CFO resources now devoted to financial statements and their audits should instead be used to develop financial and other performance measures that are important to customers and taxpayers. For example, one respondent said, "The audit is the big interaction we have with internal customers, but they [the customers] do not see this as a process that adds much value." One reason, one respondent said, is that "financial statements are for the most part meaningless to all but the dedicated readers."

Are both points of view on the value of clean opinions really opposed to each other? Perhaps not. Many CFO Act entities originally obtained, and often still maintain, their clean audit opinions through Herculean effort. Over time, as these entities improve processes and systems, the annual financial report and audit will be less burdensome.

Another factor in reducing the work of preparing financial statements is a 2004 accelerated reporting rule requiring financial reports to be delivered 45 days after the end of the fiscal year. That means there will be much less time for manual preparation of annual reports. Improvements preparing the reports will free financial managers to work on cost and other financial information that internal customers will value, information backed by the credibility of a clean opinion.

Customer feedback

Respondents listed customer feedback as an important measure of the performance of financial transactions and of the advisory and other services CFOs provide to the operations and leadership components of organizations. Feedback can come in the form of formal customer satisfaction surveys or from holding regular meetings with users of financial services and informal discussions with senior managers and executives.

Timely, high quality transactions

Both financial and non-financial executives we interviewed agree that timely, high quality finance-related transactions are extremely important. Payroll, travel reimbursement, vendor payment and other transactions are highly visible, and, when slow or problematic, are highly vexing to customers. Indeed, many respondents said that there is nothing more irritating to customers than not having their travel vouchers processed on time. Despite the importance of transactions, several CFOs complained that their time was being consumed by managing these routine activities instead of working on areas of more importance to agency management.

Some interviewees were pleased to have outsourced routine transactions to shared services centers or contractors, a practice discussed in detail in AGA's 2003 CFO survey, *Financial Operations: Who Will Do It in the Future and Why?* In that survey, several CFOs envisioned a future in which many financial functions take place outside agency boundaries. This includes all mechanical or routine financial transactions and some higher-level support activities that are handled through outsourcing, cross servicing and federal franchising.

President's Management Agenda

In last year's AGA survey of the CFO community, *Financial Management 2004: Meeting the Challenges Facing CFOs*, we found that government financial executives supported the President's Management Agenda (PMA) and its red-yellow-green system of scoring agencies on management and administrative processes. The same was true in this 2005 survey, and for the same reason: PMA drives change.

Respondents especially like the increased visibility given to "Improving Financial Performance" and "Budget and Performance Integration," two of the PMA five government-wide initiatives. One respondent said the PMA is replacing the Government Performance and Results Act of 1993 in value and attention.

A few CFOs are using internal PMA-like ratings to drill down into agency operations to align lower-level management improvements with national policy. One incorporates PMA initiatives into a department-wide strategic plan that includes goals of creating a single financial information system and reducing improper payments. Also, it motivates results, according to an interviewee, because "what gets measured gets done."

Some of our interviewees criticized the PMA government-wide initiatives as a "one size fits all" approach that in some agencies may be drawing attention and resources away from higher priorities. Another complaint was that the PMA was too process oriented at a time when government should be concentrating on outcomes. Some interviewees said that agencies have been known to game the PMA methodology. According to one, "we are putting in new systems throughout the federal government and are getting green marks for the PMA, yet many of the systems don't work."

FEDERAL CFO COUNCIL PERFORMANCE MEASURES

- Fund balance with Treasury
- Amount in suspense greater than 60 days
- Delinquent accounts receivable from the public over 180 days
- Electronic payments
- Invoice payments (non credit card invoices paid on time and interest penalties paid)
- Delinquency rates for travel and purchase cards

CFO COUNCIL MEASURES

In October 2004, the federal CFO Council, composed of the CFOs and deputy CFOs of the 24 entities covered by the CFO Act of 1990, released a set of performance measures for financial functions. For many respondents, these indicators represent the lowest common denominator for measurement.

According to an executive who participated in the initiative, “The Council selected these measures because we needed a baseline set of performance indicators, but did not have the time to explore a broader set of measures in the 60-day time limit allocated to the task. The list is not indicative of comprehensive measurement.” What the measures have in common is that the 24 CFO Act entities collect the information already, and this facilitates comparing their performance.

Most respondents said that the measures are helpful or at least “nice to have.” Some respondents said the measures are a good baseline and help to highlight areas needing improvement. Of those responding to the question, the majority indicated that the Council’s new indicators would not change how they measure things now.

Though positive about the measures, a significant number of respondents also thought the problems the indicators help identify are relatively minor. One respondent said, “You have to get everything on that

list right, but we are far beyond those measures now.” Another said, “In some ways, these measures may be a disservice because they emphasize stereotypes, meaning all the CFO does is back-office type things.”

The latest measurement results of the 24 CFO Act entities may be compared on the Council Metric Tracking System—Public, at www.fido.gov. Some interviewees said that such benchmarking would become more valuable as agencies do more shared services or the OMB’s Lines of Business (LoB) and e-Gov government-wide initiatives. LoB initiatives of particular interest to the CFO community include Financial Management, Human Resources, and Grants Management; e-Gov efforts include e-Payroll and e-Travel. Those with the best scores will likely attract more partners. However, some respondents cautioned about comparing the results of agencies with very different types of operations, missions and structures. Scores need to be considered in context, according to one, who pointed out that, “We have a multi-billion dollar budget, and purchase cards buys make up a tiny part of that.” An agency’s percentage of payments made electronically is another example, an interviewee said. While it makes sense for some agencies with millions of small payments per year to have a high percentage of those payments made electronically, such is not the case for agencies with relatively few but large payments.



“ULTIMATELY, WE WILL FIX ALL THE TIMELINESS AND ACCURACY PROBLEMS IN GOVERNMENT FINANCIAL DATA, BUT WHAT WILL WE DO WITH ALL THAT INFORMATION?”

—*Survey respondent*

WHAT DO CUSTOMERS WANT?

In AGA's 2004 survey of the CFO community, we found that financial executives' ideas of what matters most to their customers differed somewhat from what customers themselves want. The same is true in 2005, as is shown below.

TOP FOUR CUSTOMER MEASURES

What federal financial executives think their customers want or measure:

- Timely, accurate, reliable and useful data
- Advice and assistance on meeting requirements, measuring performance
- Timely, high quality transactions
- Audit results

What executive customers say they want from the financial community:

- Analytical and planning capability
- Advocacy for the budget: Get us more money
- Financial systems that reduce labor and add value
- Timely, high quality transactions

According to these results, the CFO community as a whole when considering customer needs tends to think of data, compliance, transactions and financial reporting.

Executive customers, however, give higher priority to more sophisticated support in areas like cost/benefit and other analysis involving finance, planning and advocacy with OMB and the Congress. The executive customers also want financial systems that will reduce the workload of non-financial personnel, such as by reducing the need for reconciliations, and that add value to operations.

Several CFOs are confident that customers understand the value the financial community adds to agency operations, and that the feeling will increase as more attention focuses on internal control. For the most part, these CFOs believe they have good relations with other executives, interact with them frequently and have a "place at the table" in top leadership meetings. They will do well by staying focused on the right side of the chart. This is especially true in the area of advocacy: CFOs need to become stronger program and budget advocates in the eyes of the senior leadership of their organizations.

Other respondents did not believe that non-financial personnel give the financial functions very much thought. One respondent said, "The office of CFO is peripheral to the mission of the agency and to the agency's internal customers. A low profile is best for the CFO office—we want to have no negative impact on customers." Such CFOs tend to concentrate on the accounting and financial transactions tasks on the left side of the chart and thus have little time for more sophisticated customer assistance.

FUTURE MEASURES

Future CFO Council and other financial measures will need to be more sophisticated and oriented toward the front office operations and not the back office, according to several respondents. "The first set of Council metrics are good technical measures," a respondent said, "but when you get into the softer stuff like budget and performance, it is a little more challenging. Overall, the CFO Council measures are very good from a financial standpoint. *What counts is whether you use the results to make effective changes to meet the priorities of the organization.*"

In addition, the measures must have teeth. Some respondents said that the salaries and bonuses of executives and some managers are linked to performance measures of various types, including audit opinions, PMA scores

and those released by the CFO Council. One respondent said, "Forget about all the mandates—this is a business and we can't see it fail. You have to link a performance measure to a manager and the CFO. You either think something is important or you don't." Another said, "The benefits of performance measurement outweigh the costs, because they are essential to trust and confidence."

Finally, any measures developed are good only when used for a purpose. One respondent said, "You have to consider two things: first, producing information in a timely and accurate manner, and, second, *doing something with that information.* There is no point in accuracy if you do not use performance measurement data for making decisions. Ultimately, we will fix all the timeliness and accuracy problems in government financial data, but what will we do with all that information?"

INTERNAL CONTROL



Traditionally, CFOs in both the corporate and government communities have been responsible for all aspects of internal control, including financial reporting, effectiveness and efficiency of operations (e.g., agency mission) and compliance with laws and regulations. In the wake of private sector financial scandals, internal control is receiving increased attention in the public sector, such as new requirements from OMB for federal agencies. How is the government CFO community responding to the changes?

LACK OF ATTENTION IN THE PAST

Many interviewees said that, over the years, internal control activities in the federal government have often been perfunctory. For example, one said, “Most internal control work is done at the end of the year. It is a paper exercise with levels of signoff but minimal testing or examination. It is top-down driven and has little effect on program operations.” Several mentioned that program or operations managers, who play the most important role in internal control, do not even understand why controls are important to mission, much less care about them.

A NEW SET OF RULES

Recently, the federal government re-examined its existing internal control requirements for agencies in light of the new rules for publicly traded companies contained in the Sarbanes-Oxley Act of 2002. The result was the December 2004 issuance of revisions to OMB Circular A-123.

REACTIONS TO REVISED OMB CIRCULAR A-123

Some interviewees said that they were already headed in the direction indicated by the OMB circular. Many interviewees applauded the circular for the attention that it draws to persistent problems in internal control. For example, the circular requires an agency chief or departmental secretary to certify the adequacy of controls in an organization, which helps to explain an upsurge in top-level attention to this area. “The new circular gives you leverage because of the increased attention to internal control,” one respondent said. “I wish I could say that we would have done it anyway, but we haven’t.”

Another respondent said, “This year we have eliminated more material weaknesses than in the history of the department.” While the new circular is too recent to have caused that amount of activity, the Sarbanes-Oxley Act spirit and, according to one participant, “more proficient auditors,” has helped to motivate action.

2004 REVISIONS TO OMB CIRCULAR A-123, *Management’s Responsibility for Internal Control*

The OMB circular requires agencies to:

- Provide a separate statement of assurance on internal control over financial reporting
- Segment and identify assessable units
- Document controls, assess the associated risks and perform a detailed review of controls to ensure they are functioning as intended
- Assess controls at the entity and transaction/ process levels
- Integrate government-wide initiatives with internal control requirements

RECENT CFO COMMUNITY ACTIVITIES RELATED TO INTERNAL CONTROL

Asked about their internal control activities in the last 24 months, interviewees reported that they are:

- Adding “no material weaknesses in internal control in areas managed” to executive performance evaluations
- Appointing special staff or a committee to work on internal control
- Conducting quarterly reviews of internal control with major divisions
- Creating a culture that values and supports control
- Defining assessable units down to the lowest appropriate level, allowing for excellent drill down
- Documenting previously undocumented processes
- Establishing closer working relationships with chief information officers
- Formulating an audit remediation model
- Improving financial information accuracy
- Increasing interagency coordination to mitigate material weaknesses and correct internal control problems
- Integrating internal control into other mandates and initiatives, as required by revised OMB Circular A-123
- Reducing complexity by standardizing or centralizing financial and other operations
- Resolving material weaknesses instead of just tracking them, providing adequate funds for the fixes, and reporting regularly to the agency chief or departmental secretary on progress
- Reviewing regulations and new organizational documents to remove causes of internal control problems
- Structuring a new compliance framework to set up an early warning system
- Studying and adopting best practices in internal control using intra-agency comparisons
- Training personnel on internal control, including:
 - Mandatory training on revised OMB Circular A-123 for all executives
 - Web-based training and communication tool to assist in self-assessment from the bottom up
- Updating controls annually
- Using risk management in order to avoid onerous or unnecessary controls

Also welcome is the more comprehensive approach of the OMB circular. One respondent said, “The circular tells you more than previous versions and is more aligned with current thinking on controls.”

A few respondents had neutral or negative reactions to the OMB circular. For example, one said the circular has minimal impact on his organization, which was “already headed in that direction.” Another said the new requirements “are not rigorous enough.”

Finally, a few respondents pointed out that a new emphasis on internal control has made CFOs more visible and important to an organization’s mission. This opens more opportunities to play a role in operations improvements.

PRICE OF COMPLIANCE DEPENDS ON RISK MANAGEMENT

Corporate CFOs at first estimated that the Sarbanes-Oxley Act would cause only minor increases in the cost of financial reporting, controls and compliance. However, costs have skyrocketed as companies gain more experience with Sarbanes-Oxley. For example, a 2005 *Book of Numbers* report by The Hackett Group says that a typical

finance organization has increased compliance management costs by 27 percent over the past 24 months. At the same time, according to The Hackett Group, the time required for month-end closing cycles have increased for the first time in recent years.

What will be the extra cost of the OMB circular? Survey participants’ estimates ranged from zero all the way up to \$100 million for initial costs and ongoing maintenance. Low-side guesses came from respondents who said they were already compliant or that controls were fully integrated into their operations. High-siders said their assessments depended on risk management. According to one, “If we are hard nosed about it, there would be significant costs in complying with the new A-123. If you really do everything that is required, you would have to open a new office. If the new A-123 is interpreted to mean working on every single function and doing risk assessment and mitigation plans on each, then it is going to cost a lot. Instead, we have to look at the things that really are the biggest risks. If we do it from that point of view, it is a more practical, meaningful exercise.”

Interviewees also offered opinions on the return on effort for implementing the OMB circular requirements. One said the benefits should be fewer hours spent on internal control, fewer and less problematic audit findings and the ability of auditors to see the changes made to controls. Others hoped for more participation in control activities by program managers. Ultimately, according to an interviewee, the result should be “no material weaknesses, no restatements and clean and timely audit opinions.”

CULTURE

As influenced by the COSO Report (*Internal Control—Integrated Framework*, Committee of Sponsoring Organizations of the Treadway Commission, 1992), both the revised OMB Circular A-123 and Government Accounting Office’s Green Book emphasize the “control environment,” which is defined as “the organizational structure and culture created by management and

employees to sustain organizational support for effective internal control.” This is perhaps the toughest challenge in internal control.

One interviewee said, “It is difficult to change the culture of an organization. Many feel that the new A-123 controls are a paper drill or stovepipe exercise. The mindset needs to change. The presentation of the new controls needs to be such that people see the value and want to adopt them rather than just pushing the paper for a while until it goes away. To generate a business process transformation, you need to integrate people, systems and processes and communicate the value of the new process. When you have a good process in place, you need to provide an incentive to others to see the value. Success stories help to communicate these values.” Added another, “Congress has to be a full partner in fostering culture for better stewardship”



“WE HAVE TO LOOK AT THE THINGS THAT REALLY ARE THE BIGGEST RISKS. IF WE DO [REVISED OMB CIRCULAR A-123] FROM THAT POINT OF VIEW, IT IS A MORE PRACTICAL, MEANINGFUL EXERCISE.”

—Survey respondent

INTEGRATING INTERNAL CONTROL

Controls added as afterthoughts often are imperfect and go unheeded. This is why it is so important to make controls integral components of processes during the design and implementation phases. Respondents offered additional ways of making integration happen, including the following:

- Collecting performance measurements more frequently, as part of an early warning system of problems
- Establishing a culture supportive of sound controls (as called for in revised OMB Circular A-123 and in the COSO Report)
- Focusing more on knowns rather than unknowns and on outcomes rather than outputs to bring a risk management-, customer- and results-oriented balance to internal control
- Including control activities and results in pay for performance plans for all personnel
- Incorporating controls into processes that are aligned with strategic goals that will help achieve them
- Instituting performance measures for internal controls. If controls are important, their performance should be measured
- Making performance of controls part of agency- and department-balanced scorecards

INTEGRATING PERFORMANCE MEASURES AT THE AGENCY AND DEPARTMENT LEVEL

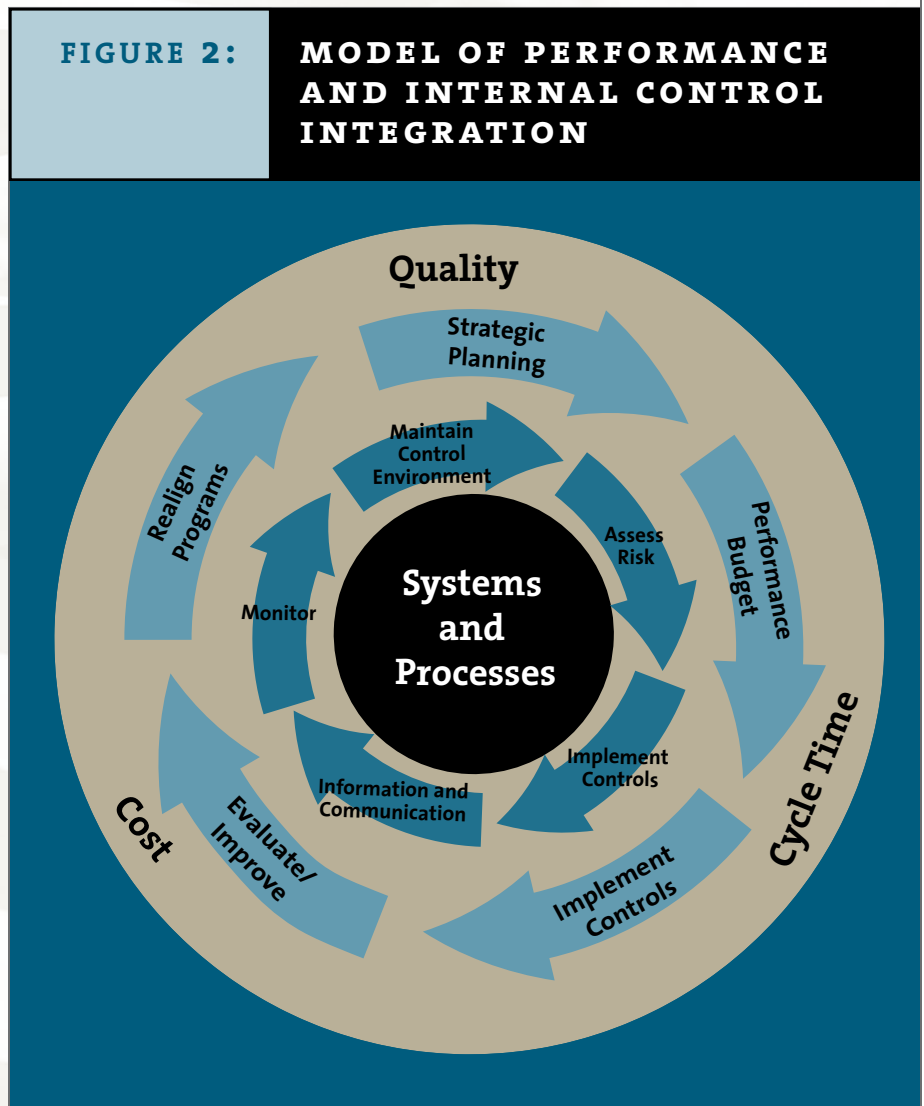
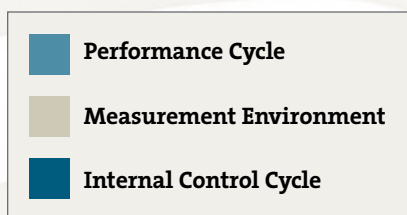


In the model in the figure below, two ongoing cycles are shown that are found in organizations with sound management: performance and internal control. Each operates in a measurement environment that includes indicators for quality, cost and cycle time, and operate around systems and processes. Such models are possible only if an organization integrates performance measurement with performance and internal control cycles.

The most profound idea in the model is that the value of performance measures and controls depends on how well they are integrated. At the corporate level—the agency or department in the federal government—keeping these elements separate may be the cause of many of the major problems in financial management, budgeting and achieving strategic goals. However, bringing the three together is a major challenge. When the union is achieved, the results are performance management (managing for results) and performance-based budgeting (formulating budgets based on expected outcomes per dollar invested).

FIGURE 2:

MODEL OF PERFORMANCE AND INTERNAL CONTROL INTEGRATION



USING INTEGRATED MEASURES FOR STRATEGIC, POLICY AND BUDGETARY DECISIONS

Many respondents reported their agencies are tying performance measures to strategic plans, goals and objectives and to five-year plans. Fewer managed to link measures to budgets, but those that did often had integrated measures to strategy beforehand. One respondent said, the key to this is to “have measures that fit the overall mission of the agency or program, instead of microscopic measures imposed by outside oversight organizations on low-level budgeting.”

For the measurements to count, measurements have to have an impact on the personal performance of senior management. For example, one respondent said, “You have to give people incentives to want to reach strategic goals and objectives. We tie the attainment of goals to the salaries of our executives and senior managers, who have part of their pay at risk, to be determined by corporate performance targets and achievements.

In addition, our non-union employees have incentives through a three-tier pay and bonus system.”

Even when agencies manage to include performance measures as part of their justifications in Congressional budget submissions, the chances are the numbers will do them marginal, if any, good. Echoing complaints heard in AGA’s 2004 survey of the CFO community, several 2005 survey respondents said the major barrier to integrating performance measurement into budgetary decisions is that Congress does not react to positive numbers when making decisions about budgets. Indeed, although negative numbers may cause an agency chief or secretary to be called before committee, performance measures appear to have little effect on the amount of an agency’s budget. What hurts the cause the most may be that, in the words of one Congressional staffer, “Sometimes the Congress says *don’t* use performance budgeting.”





MORE INTERACTION AMONG FINANCIAL AND PROGRAM MANAGERS

“You can’t get to integration of budget, measurement and performance unless you get the active participation of program managers,” one interviewee said. A majority of the interviewees who addressed the issue of the quality and extent of interaction between financial and program managers believe that the relationship is improving. In some agencies, the improvement is rooted in increased use of managerial cost accounting, including activity-based costing (ABC). In several others, more interaction is driven by heightened attention to controls, which have of late become more important to program executives and senior managers because of the revised OMB Circular A-123.

Respondents also mention the following ways in which financial and program managers have enhanced their relationship:

- Frequent senior staff meetings that include financial and program executives and managers, from the Senior Executive Service down to middle-level managers
- Video teleconferences on process and program improvement
- Networks of CFO councils within a department that communicate with program colleagues at different levels
- Budget analysts work closely with program managers
- Change the curricula of senior management training to include more resource management in strategic courses

Despite this progress, some respondents reported little or no change in the level of interaction between financial and program personnel. Short-term progress will depend on a stronger sales effort by the CFO and other financial leaders, although in the long term the two groups will likely work more closely because of increased cost accounting and more focus on internal control.

SUGGESTED CHANGES IN REQUIREMENTS

Respondents were asked to supply their ideas and recommendations for improving federal requirements related to performance management and performance-based budgeting. What follows is particularly valuable, because participants at this point in the interview had had the opportunity to consider nearly every aspect of performance measurement, internal control and financial measures. The government should consider the following changes:

- Develop a better reward system for good performance where programs that do well receive more funding, or at least provide more discretion on how they execute their spend plans
- Consolidate and make consistent requirements and guidance from multiple sources on performance measurement and internal control
- Review the usefulness of the requirements and guidance, doing a cost/benefit analysis that considers the limited resources to do the work required for compliance
- Set up government-wide standards for performance, where appropriate
- Require agencies to focus more on reporting the health and net operating results of their organizations
- Create a level playing field based on sound enterprise-wide use of cost accounting at all levels of management
- Return to the practice of performing program evaluations

ACTIVITIES LEADING TO BETTER INTEGRATION

Interviewees had many suggestions for improving the integration of performance, financial measures and controls in their agencies. These include the following:

- Setting priorities, because there are too many things going on in performance management today; that is, the fewer things to consider, the easier they will be to integrate, including measures, controls and systems
- Moving funds now spent on financial reporting to performance measurement and cost accounting initiatives, which have more potential for improving results
- Having OMB provide more concrete and consistent standards and feedback on measures
- Introducing more standard operating procedures and consistent documentation of processes
- Installing good cost-accounting systems
- Vesting responsibility for performance and financial measures and controls in one person, the CFO

- Improving communication between lines of business and the finance office
- Providing more details on cost differentials, analysis and corrective actions
- More strategic goals and tools and measures and guidelines geared to the goals
- Measuring the performance of controls through established, regular indicators

The hardest part of integration is “to get people to want to do it,” a respondent said. Motivating change requires management to promote integration and to show its benefits, to focus on outcomes and to continue to improve communication between the financial and financial and program communities. One respondent said, “More time is needed to roll out performance measurement/monitoring criteria to managers to put in their annual assessments and then roll down to their employees. This includes training of personnel in the need for and how-to of integration.”

“MORE TIME IS NEEDED TO ROLL OUT PERFORMANCE MEASUREMENT / MONITORING CRITERIA TO MANAGERS TO PUT IN THEIR ANNUAL ASSESSMENTS AND THEN ROLL DOWN TO THEIR EMPLOYEES. THIS INCLUDES TRAINING OF PERSONNEL IN THE NEED FOR AND HOW-TO OF INTEGRATION.”

—Survey respondent



TOP CONCERNS OF THE CFO COMMUNITY IN 2005



Survey participants were asked about their top concerns for their financial organizations. The five most-mentioned worries were:

- Oversight and government-wide initiatives
- Financial systems
- Human capital
- Annual financial statement reports and audits
- Performance measurement

AGA's 2003 and 2004 surveys covered in detail the first three concerns. Here we will, when possible, compare the 2005 survey responses to the previous two years' responses.

OVERSIGHT AND GOVERNMENT-WIDE INITIATIVES

Both the 2004 and 2005 surveys reported that agencies face too many reporting requirements from Congress, OMB, the Government Accountability Office and other organizations. In both years, agencies are overloaded with OMB's government-wide Lines of Business and e-Gov initiatives, and few have received additional funds for these new endeavors.

Oversight organizations, Congress and the Executive Office lack a comprehensive long-term vision or plan for how the business of government should be managed. As a result, there are conflicts in priorities and imprecise objectives. In 2005, many survey respondents called on the oversight organizations to set priorities for all their financial and management requirements and initiatives.

FINANCIAL SYSTEMS

Federal financial management systems are proving to be more expensive and difficult to change than anticipated, and failures in system operations and applications continue. The government is plagued with persistent problems in resource-draining legacy systems and getting older users to adopt new systems. Although it is important to stay abreast of new technology, some respondents think that some agencies are getting green scores on their PMA results by installing new systems that do not work.

On the plus side, some new systems are effective, user friendly and promote integration and standardization. Several interviewees mentioned making more use of cross servicing in the future. Also mentioned was that the OMB Lines of Business initiative will drive more consolidation of accounting and other services, which means fewer and more standard financial systems.

HUMAN CAPITAL

Having the appropriate personnel to perform financial functions was reported as a concern both in 2003 and in 2004. Respondents in 2003 said they were worried that their current workforce did not have the experience and skills for analytical work that supports program and executive management. Respondents were also concerned about a shrinking workforce, especially because overhead and administrative functions such as finance were more vulnerable to budget and staff cuts.

In 2004, respondents were less worried than we expected about the looming rush to retirement of Baby Boom financial executives and managers. This was because the surge was not huge and steps had been taken to motivate key senior staff to stay on.

Still, 2005 survey respondents were somewhat concerned about retirements, and still felt that middle- and lower-level personnel lack the skills needed

PERFORMANCE MEASUREMENT SHOULD LEND ITSELF TO SCENARIO BUILDING AND MODELING TO HELP DETERMINE RETURN ON INVESTMENT. AGENCIES SPEND TOO MUCH TIME FILLING IN THE BLANKS OF PERFORMANCE REPORTS FOR OVERSIGHT ORGANIZATIONS AND CONGRESS.

for modern financial management. The 2005 survey indicates that the CFO community thinks that overly complex civil service rules make it difficult to recruit entry-level talent and make it nearly impossible to hire middle managers from outside the government.

Budget and personnel cuts are shrinking the number of financial personnel, but the level of work required remains the same or is increasing. Both the 2003 and 2004 survey reports provide details on possible solutions. The 2003 survey addresses how to meet human capital needs by changing the model of federal financial operations in government to use more outsourcing, cross servicing and federal franchising.

ANNUAL FINANCIAL STATEMENT REPORTS AND AUDITS

In the wake of Enron and other corporate financial scandals, the private sector has become more cautious about financial auditing. However, the government already is cautious, perhaps to an extreme that is slowing progress in financial management improvement. Over the past few years, most agencies have identified and corrected major problems uncovered by annual financial statement audits. However, 2005 survey respondents say auditors have become more proficient in digging out minor problems, and that the cost of fixing these problems may not be worth the

resources required. Better priority setting and policies on materiality would help strike a better balance.

Some interviewees said that too much focus on financial reporting in government drains resources from other improvements that would provide better service to customers. They pointed out that customers simply do not value, much less read, the information in financial statements.

PERFORMANCE MEASUREMENT

In the 2004 survey, interviewees reported that program managers were starting to get serious about cost and performance information. As can be seen throughout the 2005 survey, the conversion will likely take a while.

Exactly what doctrine will fit best is yet to be determined, but in the 2005 survey interviewees offered suggestions: government needs to pay more attention to outcome measures and less to process measures, especially when looking at mission performance. Performance measurement should lend itself to scenario building and modeling to help determine return on investment. Agencies spend too much time filling in the blanks of performance reports for oversight organizations and Congress. Few agencies have really tied performance measures to compensation.

GOING FORWARD



For the past decade, the federal government has been engaged in devising the components of sound performance management. Now, 15 years after the 1990 CFO Act was passed, it is time to start assembling the parts into effective, integrated approaches to managing outcomes, operations, budgets and finance. To be effective in managing performance, we do not believe that every agency needs every measurement now required of it by oversight organizations.

OUR OPINION IS THAT TOO LITTLE EMPHASIS HAS BEEN GIVEN TO CONTROLS RELATED TO THE ACCOMPLISHMENT OF AGENCY MISSION AND TO KEY OPERATIONS THAT PRODUCE MISSION-RELATED OUTCOMES.

Indeed, we question whether the outside organizations actually use all the performance data they require of the agencies. It would be better for agencies to have the leeway to construct their own performance management systems, subject to clear but flexible guidelines. It would be more cost effective for oversight organization as a group to set priorities for the performance data they now require of the agencies, and then start adding consequences for not meeting performance targets in the most important areas.

Internal controls are not simply for reducing the risk of fraud, waste and abuse. While viewed in that light, controls will never be part of mission management.

Our opinion is that too little emphasis has been given to controls related to the accomplishment of agency mission and to key operations that produce mission-related outcomes. Even where mission-related controls exist, quite often they lack performance measures that would indicate whether the controls work according to plan. Oversight agencies would do well to pay more attention to these mission-oriented measures of control.

To conclude, measures and controls are worthless unless they are used to monitor, improve and maintain the effectiveness of processes and systems. Going forward, we should pay more attention to using high-priority measures and controls rather than to developing new ones.



ADDITIONAL INFORMATION

If you would like more copies of this survey or an opportunity to hear more about its content and the challenges facing the federal CFO community, please contact the Association of Government Accountants at the addresses below.

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