Protect Your Community with Financial Planning

by Shayne Kavanagh

Long-term financial planning combines financial forecasting with financial strategizing to identify future challenges and opportunities, causes of fiscal imbalances, and strategies to secure financial sustainability. Participants in the planning process consider a range of possible futures confronting the organization, examine the financial consequences of those possibilities, and determine the most appropriate policy and strategy responses.

It is from this broad consideration that the primary benefit of financial planning flows: to stimulate discussion and thinking about the long-term impacts of decisions made today and how the organization can begin positioning itself now to meet challenges, exploit opportunities, and deliver a stable level of essential services.

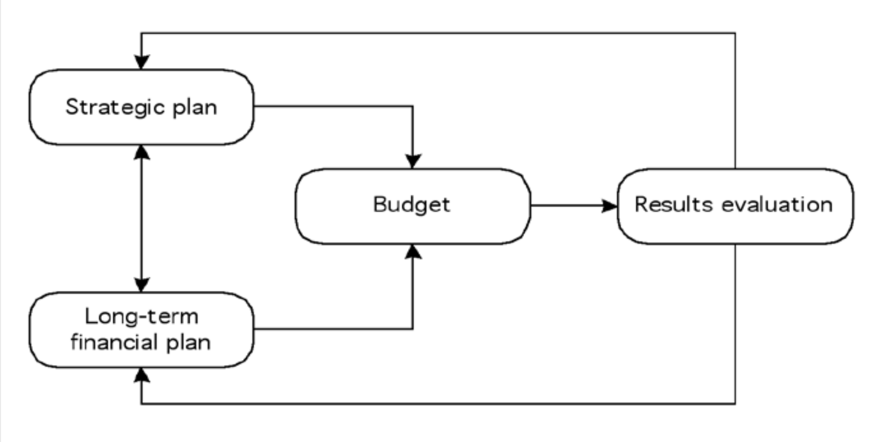
Long-term financial planning, strategic planning, and budgeting combine to form a full system of planning and evaluation. Figure 1 on page 19 shows how financial planning and strategic planning work together to establish long-term, strategic direction, which then affects the budget process. The budget is used to operationalize strategies called for by the financial plan and strategic plan.

Results are then evaluated, which causes financial planners and strategic planners to modify plans and strategies. Thus, long-term financial planning is an essential piece of a government's planning framework. As the person responsible for helping a local government establish a clear strategic direction and then taking the organization in that direction, the local government manager is profoundly influenced by long-term financial planning.

The Government Finance Officers Association (GFOA) has been conducting extensive research on long-term financial planning as it has become a topic of increasing interest given the environment of fiscal constraint in which many public agencies now find themselves. The purpose of this article is to describe how financial planning, which is often primarily sponsored from outside the manager's office—typically by the chief financial officer (CFO)—affects the management of city and county government, the role of the manager, the budget process, and the manager's relationship with the CFO and elected officials.

For this article, GFOA interviewed the city managers and CFOs of six communities of varying sizes; these officials also have varying experience in long-term financial planning.

Figure 1. A Comprehensive Planning Framework



A financial plan works with other planning processes to form a complete planning framework.

MANAGEMENT OF THE ORGANIZATION

Long-term financial planning emphasizes the long-term effects of decisions made today. By making the long-term consequences of decisions apparent through tools like long-range forecasts and financial performance measures, financial planning transforms discussions that occur among the management team and elected officials.

The common experience of the interviewees was that their councilmembers have become much more cognizant of both short-term funding and long-range financial sustainability when they consider new programs. This is crucial in an environment of fiscal constraint where it might otherwise be tempting to implement band-aid solutions to financial problems that can hurt the locality over the long term—solutions such as asset sales or deferring maintenance expenditures. In fact, in San Clemente, California, a city with a long history of financial planning, the council now routinely *insists* on an analysis of the long-term financial impacts of all programs and initiatives.

The move toward a long-term perspective also influences staff. This is manifested primarily through the transformed role of the CFO and the budget process, both of which are discussed later in this article. It also applies, however, to other decisions taken by departments as they become more cognizant of the financial implications of their activities.

As a result of this emphasis on long-term thinking, a more rigorous test is established for undertaking new programs and services. For instance, the cost of operating and maintaining an asset after it is built is given greater weight in capital planning, and the ability of the city's revenues to keep up with rapidly escalating employee benefit costs is given careful thought if the city is considering increasing the city workforce to provide a new service.

This means that the city manager must more carefully plan how to meet the city's service-level objectives because initiatives that may have passed muster in the absence of a long-range perspective may not pass when the sustainability of those initiatives is considered over the longer term. Hence, long-term planning promotes the creation of a stable set of services and service level expectations that can be consistently funded over time.

The second major impact of financial planning on the management of the organization is the shared understanding of the community's priorities produced among council and staff. Sound financial planning requires that the government produce an explicit consensus in a number of areas. Of four such areas listed below, the first two occur at the beginning of the planning process, and the last two occur at the end:

Financial policies. The baseline standards for how stewardship over the community's financial resources will be maintained.

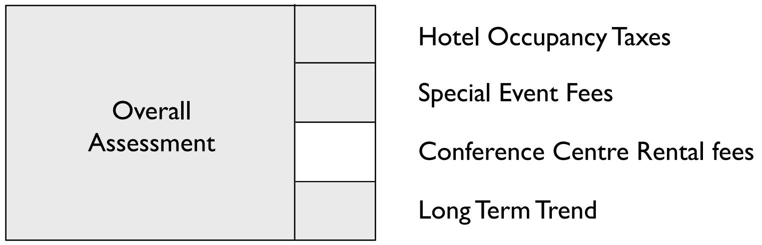
Service-level preferences and policy. A financial plan must be created in the context of the services that the community intends to deliver to its citizens. These may be expressed as qualitative goals and objectives or as quantitative performance measures.

Financial strategies. Strategies for addressing financial imbalances such as revenue shortfalls or spiraling areas of expense.

Monitoring mechanisms. Techniques for monitoring progress against financial strategies. Examples include action or project plans and performance measures.

When created through an inclusive and consensus-driven process, these bookends of financial planning

Figure 2. Addison's Hotel Fund Revenues



Addison's dashboard communicates key financial information at a glance.

establish a clear set of parameters for decision making. To illustrate, Long Beach, California, created the following financial policy: "General fund long-term debt payments shall not exceed 10 percent of operating expenditures. In addition, the city shall not issue long-term (more than one year) general fund debt to support operating costs." The policy provides guidance on acceptable uses of debt and thus creates a parameter on decision making designed to preserve financial condition.

The third and final change to organizational management is the reconception of financial information and reporting. Traditionally, financial reporting has been based on trailing indicators (what has happened in the past) and often focuses on spending control. With long-term planning, the focus shifts to the information needed for long-term decision making and for best addressing the community's priority issues. Addison, Texas, developed a simple and effective quarterly "dashboard" of key indicators. A dashboard for the town council summarizes the performance of important funds. An example of one such dashboard for hotel fund revenues is shown on this page (Figure 2).

The predominantly green coloring denotes that revenues are mostly within acceptable ranges, with the exception of conference centre revenues, which is an area of concern as denoted by yellow. This snapshot of key financial information helps direct discussion toward the larger areas of concern for the city and away from individual budget line items.

A similar but more detailed dashboard is created for executive staff. Their dashboard covers financial, economic, and operational indicators, including more forward-looking indicators. It includes, for example, trends on hotel occupancy rates and revenue per available room that are prospective indicators of hotel fund revenue.

Monitoring of key indicators and forward-looking analysis allows the manager to better anticipate concerns of the council and community and to formulate responses. This kind of analysis also gives the manager and council more confidence to take a response because the long-term implications of that response are clearer.

ROLE OF THE MANAGER

Because long-term financial planning affects the fundamental way in which the organization conducts its business, it can't help but have implications for the role of the local government manager. The most prevalent change is the increased emphasis on financial issues as a strategic concern for the manager.

Many managers are already deeply involved in financial issues, but this does not mean that the manager now begins to take over the CFO's responsibilities with the advent of financial planning. It means that the manager spends more time thinking strategically about financial issues and more time interacting with finance staff as the information they produce becomes more relevant to strategic considerations and as long-term financial stability is elevated to an organization-wide priority.

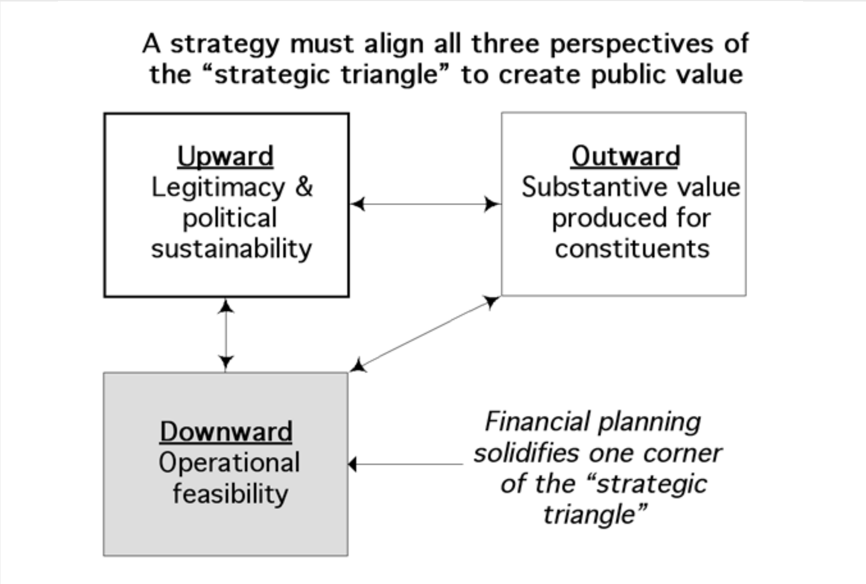
In Addison, Texas, for example, long-term forecasting of the city's revenues and expenditures suggested that the city needed more financial flexibility because continuation of then-current trends would have caused the town to fall below its policy for minimum levels of fund balance. This led the town manager to spearhead an organizational redesign to reduce the town's long-term, structural cost. The result was a $1.6 million savings over five years and, more important, a thorough examination by the town and its departments of how best use of available resources could be made to meet service objectives.

One of the greatest virtues of a good manager is the ability to accomplish work through others. Accordingly, as the manager becomes more attuned to financial concerns, the manager develops a collaborative approach toward maintaining financial stability with the other members of the executive management team.

Because financial planning creates a more rigorous test for new or expanded services, spur-of-the-moment or go-it-alone decision making becomes less feasible. Shared decision making and concerted action is required for the locality to make best use of available resources. In a number of the cities in which the manager and CFO were interviewed, for example, the executive staff held quarterly meetings at which the entire executive staff reviewed progress toward service-level and financial goals, and, like Addison, they often used key indicators or scorecards.

In government the creation of value is not defined in terms of financial resources as it is in the private sector. Instead, it is defined terms of achievement of an outcome of value to constituents. Financial resources, however, do enable a public agency to create value. Mark H. Moore, author of *Creating Public Value: Strategic Management in Government* (Cambridge: Harvard University Press, 1995), points out that, when considering a strategy to create public value, public managers must focus attention "outward" toward the value produced

The Financial Plan and the Strategic Triangle



for constituents by the agency, "upward" toward the political definition of value, and "downward" toward the organization's current performance and capacity.

When all three pieces of this "strategic triangle" align, the agency is optimally positioned to create public value. Long-range financial planning makes the manager a more effective strategic actor by solidifying the downward perspective and providing the manager with a clear picture of current financial condition and an assessment of likely future position.

This allows the manager to work more effectively with elected officials (upward) and constituents (outward) because the manager is more confident of having personal knowledge of financial and organizational resource capacity (downward). As Erik Kvarsten, city manager of Gresham, Oregon, put it: "Clarity of resources makes the city manager better able to craft and clarify the choices and challenges faced by the organization over the long term and injects reality into decisions."

BUDGET PROCESS

As the introduction to this article described, the budgeting and long-term financial planning processes are inexorably linked. Managers are often heavily involved in the budget process because the budget is a government's single most important operational and policy document. The experience of the interviewees suggests that financial planning can greatly improve the budget process by reducing conflict, creating greater structure and discipline, and improving monitoring of plan or budget implementation.

Budget formulation is often characterized by fierce competition for limited resources. Although a financial plan cannot eliminate all such tension, it can help mitigate it. The emphasis placed on long-term thinking and the shared understanding of community priorities provides an overarching context for the budget process. This gives departments a greater appreciation of how the full range of local services fits into the city's overall financial and service strategy, making the departments more understanding of resource allocation decisions, even when those decisions are not in favor of their particular programs.

The context provided by financial planning also gives elected officials greater confidence that the budget reflects the community's service priorities while it maintains the long-term financial balance. A number of communities interviewed report that, thanks to up-front financial planning, their final public budget hearings now are concluded in a matter of minutes, whereas before the hearings may have taken hours or even days.

This same budgetary context makes for a more structured and disciplined approach to budget formulation. Departments know the service priorities of the city as well as the financial constraints. This makes it possible for departments to create budget submissions that are more closely aligned with priorities and funding realities from the beginning. Departments also know that long-term sustainability of programs is a central consideration, so they address this issue in their budget requests. This reduces the long, iterative process of mutual adjustment between departments and the central authority that can occur in the absence of such a context.

Finally, a long-term financial plan includes tools for monitoring progress (tools such as performance measures and action plans) against the financial strategies advocated by the plan. Because these strategies are operationalized through the budget, these monitoring tools ultimately improve the quality of budgeting and execution against the budget. Demonstrating the success of the financial plan through these tools causes departments and elected officials to increase their commitment to planning and reinforces the transformation of the budget process from one characterized by competition between departments to one characterized by teamwork toward shared goals.

The Steps of Financial Planning

Through its research, GFOA has identified a four-phase process for financial planning:

Mobilization phase. The first step is getting ready to plan. This includes identifying the leader of the planning process, the participants, the process they will follow, issues to be addressed, service level preferences and policy, and financial policies.

Analysis phase. The analysis phase produces information that supports planning and strategizing, including environmental scanning, trend projections, and financial analysis.

Decision phase. After the analysis phase, the organization responds to the information uncovered. These decisions result in a set of financial strategies for bettering the financial position of the organization.

Execution phase. After financial strategies have been developed and formally committed to, the government carries out the financial plan through its budget and monitoring tools like performance measurements and action plans.

RELATIONSHIP WITH THE CFO

The CFO is usually the sponsor of the long-term financial planning process. Therefore, as financial planning changes the management of the organization and the role of the manager, it transforms the relationship with the CFO. The CFO becomes a strategic partner in the management of the organization, moving beyond traditional concepts of financial control to include the broader responsibility of ensuring long-term financial balance and a stream of resources sufficient for uninterrupted provision of crucial public services.

The CFO becomes the source of financial information who also understands the strategic direction and priorities of the local government. This enables the CFO to bring crucial information to the manager's attention without being asked for it because the CFO knows what information is valuable, and that knowledge is reflected in the financial reporting processes created by the CFO.

The financial plan allows the CFO to move into this strategic capacity. The financial plan creates consensus between the manager and CFO on the leading long-term considerations and financial issues facing the community. The CFO can then create a reporting and control structure and budgetary process that best address these items.

The more strategic role of the CFO requires the CFO to become more involved in the operations of local government, as concerns of financial sustainability take a higher profile. This may require some adjustment on the part of department heads and the manager, but the interviewees found this transition to be beneficial and natural, especially when the CFO takes to the role as a partner or valued adviser, rather than as a control authority. Here are examples of how the CFO has taken a greater role in operations:

Economic development. In Brookfield, Wisconsin, the CFO has taken a greater role in reviewing and advising on the large, multiyear financial commitments that are often involved in economic development projects.

Capital projects. The CFO in San Clemente, California, is involved in the initial stages of planning capital projects in order to identify funding sources and to estimate the operating costs of the asset.

Performance management. In Long Beach, California, the CFO heads the city's operational review and performance management programs because they are seen as crucial to the ongoing financial stability of the city. The CFO's personal ability to work with departments as a strategic adviser, rather than as a control authority, has been indispensable to the city's success with this approach.

ELECTED OFFICIALS

When discussing the impact of financial planning, the city managers interviewed were most enthusiastic about its effects on their relationship with elected officials. Because these effects are a natural outgrowth of the characteristics of long-term planning discussed earlier in this article, they are presented here in a summary form:

Shared understanding of priorities. The manager and council come to a common set of priorities and expectations for how these will be addressed.

Stabilized financial decision making. Elected officials focus more on big-picture financial decisions and strategies for achieving and maintaining financial balance. They more carefully consider the long-term impacts of current decisions and deemphasize discussion of budget line item detail. Elected officials like being associated with a government that has a reputation for businesslike financial planning and stability, so there is a self-reinforcing character to this impact of financial planning.

Enhanced communication with the public. The plan identifies crucial financial and service information and puts it in a format that is highly accessible and understandable. This enables elected officials to have better-informed discussions with constituents.

All of the city managers interviewed for this article have found long-term financial planning to be a boon to their city, and they have become great advocates of its practice.

Transformed relationships among officials. The financial plan is a great way to get new elected officials up to speed on the issues facing the city and the plan for addressing them. A number of the interviewees have found that the financial plan has been instrumental in making believers out of council members who were elected as skeptics of city government.

Instilled confidence. The financial plan gives elected officials confidence that the city has a clear plan for addressing its most pressing priorities and that this plan is reflected in how resources are allocated. This confidence is key to realizing financial planning's potential for transforming the budget process.

CONCLUSION

Though usually sponsored by the CFO, a long-term financial plan has profound implications for the manager's role in the local government. Fortunately, all of these implications are quite beneficial as they enhance the manager's ability to lead local government, improve communication with elected officials, and positively transform the budget process and relationship with the CFO.

All of the city managers interviewed for this article have found long-term financial planning to be a boon to their city, and they have become great advocates of its practice. In fact, Mike Parness, the former city manager of San Clemente, where he was first exposed to long-term financial planning, is now the city manager of Napa, California, where he has been the initiator of Napa's new long-term financial planning initiative. Perhaps this marks the beginning of a new trend: managers taking the lead role in making sure their local governments have this crucial practice in place. **PM**

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