

The State Needs Stronger Financial Management

Why is the State Auditor's Office addressing this topic?

The State Auditor's Office is in a unique position to evaluate the state's financial leadership and how it affects the state's overall financial management. On behalf of citizens, the Office has primary responsibility for conducting independent examinations of the state's financial statements; its use of federal grant money; its compliance with financially related laws; systems designed to provide accountability over public resources; and its efficiency and effectiveness.

The knowledge accumulated through our audit work allows us to examine financial leadership and financial management system capabilities being used to address the state's financial challenges and how they could, and should, change to address the following and other, long-term financial challenges:

- Unfunded liabilities related to pensions, the guaranteed college tuition program and self-insurance.
- A recent court ruling that will dramatically increase the state's investment in public schools.
- The cost of repairing and replacing deteriorating roads, bridges and schools.
- Enrollment increases and escalating costs in publically paid medical and other social services.
- Limited debt capacity and potential risks to the state's credit rating, which could result in higher interest costs.

"States have been grappling with their most serious fiscal crisis since the Great Depression. Even before the 2008 financial collapse, many states faced long-term structural problems, and now they face additional threats."

Source: Co-Chairs Paul Volcker and Richard Ravitch, Report of the State Budget Crisis Task Force, July 31, 2012.
www.statebudgetcrises.org

In 2011, former Federal Reserve Chair Paul Volcker and others assembled the State Budget Crisis Task Force to examine threats to near- and long-term fiscal sustainability in six states. Its July 2012 report indicates these states were experiencing common financial challenges that mirror those listed above, in part due to outdated budgeting laws and practices.

Conclusion and recommendations

The state Office of Financial Management (OFM) does a great job of supporting agencies in their financial management activities, which include planning, safeguarding and accounting for the use of public funds. However, it is not engaged in enterprise-wide strategic and financial planning. This model of leadership has continued for decades.

The state's financial management system provides effective stewardship over public resources. This includes accounting for public funds and safeguarding assets. However, its core financial system was put in place in 1984 and its enabling legislation was passed in 1959, providing OFM with primary responsibility for administering the state's financial management system. OFM has established policies and procedures that push much of this responsibility down to individual state agencies. Consequently, the state lacks strong centralized financial management.

The state has also been engaged in strategic planning at the agency level, but not for the state as a whole. The Priorities of Government process now in use is not a substitute for state-wide strategic and 10-year financial planning. The state also lacks the information and modern financial management systems and practices necessary to centrally manage and plan for its long-term fiscal challenges. The absence of a strong financial leadership has contributed to these conditions.

To address these challenges, I urge you to:

1. Consider expanding the role of the OFM Director to modernize how the state does financial management.
2. Work with the Legislature to gain financial support for the replacement of the state’s legacy systems.
3. Establish long-term statewide strategic and financial plans that reflect the priorities and expectations of the citizens.

How we approached this review

Due in large part to the recent economic recession, businesses and governments are permanently resetting how they do business. Such transformation requires modern financial management systems and practices. To identify the state’s practices and opportunities to improve them, we reviewed documents on the state’s priorities and its strategic planning and budgeting practices. We also interviewed officials at the Office of Financial Management, State Treasurer’s Office, legislative fiscal committees, and staff at the Economic and Revenue Forecast Council and the Caseload Forecast Council.

To identify the characteristics and practices of a world-class financial management system, we examined publications by the U.S. Government Accountability Office (GAO) and other professional finance and government oversight organizations shown at Appendix A. GAO identified these characteristics by reviewing a select group of states and companies, including The Boeing Co. Similar characteristics were also identified by the Certified Institute of Public Finance and Accountancy and the National Audit Office of the United Kingdom. We also examined publications on the long-term planning and forecasting practices of private and public organizations. As shown in the table below, a world-class financial management system operates with four overarching goals, twelve leading practices, and results in seven outcomes:

Goals, Practices and Outcomes of a World-Class, Financial Management System				
Success Factors	• Leadership • Culture	• Organization • Customers	• Technology • Process	• People
Goals	Make financial management an entity-wide priority	Redefine the role of finance	Provide meaningful information to decision makers	Build a team that delivers results
Best Practices	Clear and strong leadership Build a foundation of control and accountability Use training to change culture and engage line managers	Maximize efficiency of day-to-day accounting activities	Reengineer processes in conjunction with new technology	Develop a finance team with right mix of skills and competencies Build a finance organization that attracts and retains talent
		Organize finance to add value	Translate financial data into meaningful information	
		Assess the finance organization’s current role in meeting mission objectives	Develop systems that support the partnership between finance and operations	
			Integrate agency-wide long term financial plan with strategic plan to inform the budget and manage risk	
Desired Outcomes of a Mature Financial Management System				
<ul style="list-style-type: none"> • A reliable count of money spent and received • Sound stewardship of public resources and compliance with regulatory standards • Value for money; economy, efficiency and effectiveness • Service activity costs are known and analyzed to lever performance improvements 		<ul style="list-style-type: none"> • Risks are identified, evaluated and managed • Good decision making/managers and governing structures assess the financial consequences of policy choices • Organization plans for future and aligns resources with priorities 		

Source: United States Government Accountability Office, “Executive Guide, Creating Value Through World-Class Financial Management”, April 2000

How Do OFM Practices Compare to the Characteristics of a World-Class Financial Management System?

In evaluating the state's financial management system, we focused primarily on the stewardship, leadership and long-term planning practices shown above.

Successful stewardship through a foundation of control and accountability

The administration of the state's budgeting and accounting system is the responsibility of the Governor through the OFM Director. Specific duties are outlined in state law (RCW 43.88.160 and RCW 43.41.100).

OFM has established a good foundation of control and accountability over the receipt and expenditure of state funds and compliance with regulatory standards. Every year since 1987, the Government Finance Officers Association of the United States and Canada (GFOA) has awarded a Certificate of Achievement for Excellence in Financial Reporting to Washington State for its Comprehensive Annual Financial Report. The Certificate of Achievement is a national award recognizing conformance with the highest standards for preparation of state and local government financial reports.

The state, however, is hamstrung in terms of maximizing the efficiency of day-to-day accounting activities. The state's accounting system, the Agency Financial Reporting System (AFRS), is nearly 30 years old. While various features have been added to AFRS over the years, it does not provide the modern technology necessary to support efficiency of day-to-day accounting activities.

Appendix B outlines the powers and duties of state officers and agencies as provided by the state's budgeting, accounting and reporting system act – current law and legislative history.

The state's outdated financial management systems limit its ability to effectively manage its finances and performance.

Modern systems and the information they generate are critical to the new administration's LEAN management initiative, which requires data analytics the current systems do not support. Current systems also do not support the state's budgeting process. State law (RCW 43.88.090) requires agency budget requests to include performance measures to be used by OFM to objectively assess each agency's success in achieving its goals. Although OFM is supposed to consider this success when it reviews agency budget requests and prepares the Governor's proposed budget, the state's current systems cannot readily produce this performance information. It does not have the capacity to provide robust information necessary to support policy and decision making like the cost of products and services and other measures of performance.

OFM has submitted decision packages to modernize the state's budgeting and accounting system in consonance with its biennial budgets; those packages have to date not been approved or funded by the Legislature. The State Auditor's Office is in the process of conducting a performance audit on the risk and cost associated with trying to maintain the state's legacy financial systems. That audit will be issued in 2013.

The OFM Director has not assumed the role of a strong financial leader and established state-wide strategic and long-term financial planning to help manage risk.

Chief financial officers must show leadership and speak out in support of sustainability and managing risk. Although OFM is in the best position to provide this leadership, it does not follow the world-class practice of using state-wide strategic and long-term financial planning to:

- Identify financial pressures and project costs, cash flow, debt, and financial capacity over the next five- to 10-years.
- Use projected financial capacity to set service priorities and develop strategies for achieving financial sustainability and managing risk, which are incorporated into the budgeting.

State law (RCW 43.41.030) properly acknowledges the benefits of bringing the state's long-term planning and budgeting together and requires OFM to do so. But as described below, the state's budgeting process differs from world-class practices by relying on decentralized strategic planning and a four-year revenue and expenditure outlook:

"States should enact multi-year forecasts and plans that extend at least four years beyond the current budget year, in order to increase their ability to make better short-term decisions and improve long-term outcomes. States should encourage independent review of their budget forecasts. Above all, states need rules that encourage them to adhere to these plans, so that the longer-term consequences of budgetary decisions become apparent."

Source: Co-Chairs Richard Ravitch and Paul Volcker, Report of the State Budget Crisis Task Force, July 31, 2012.
www.statebudgetcrises.org

- The Governor initiates the budgeting process by establishing the state's service priorities. Because OFM does not prepare a long-term financial plan, these priorities are established without a sufficient consideration of sustainability and risk.
- The state's strategic planning occurs at the agency level. OFM provides guidance to agencies on how to prepare those plans. This guidance instructs each agency to establish a plan that reflects the Governor's priorities and to consider that plan in its budget request. However, this guidance does not tell agencies how far out to plan or the resources that are anticipated. Moreover, OFM does not review these plans or consider them when it establishes the Governor's budget proposal, which is submitted to the Legislature.
- The Legislature adopts the state's two-year budget taking into account the Economic and Revenue Forecast Council's four-year budget outlook. As prior budgets were adopted using a two-year outlook, this is an improvement.

The state's fiscal challenges are expected to extend to at least the 2015-17 biennium. If the state continues to budget without the use of state-wide strategic and long-term financial planning, it cannot adequately manage its risks and assure sustainable services.

Appendix A

Sources Researched to Identify Characteristics of World-class Financial Management

Report of the State Budget Crisis Task Force, Published by the State Budget Task Force on July 31, 2012
<http://www.statebudgetcrisis.org/wpcms/wp-content/images/Report-of-the-State-Budget-Crisis-Task-Force-Full.pdf>

Managing the Fiscal Metropolis by Rebecca M. Hendrick, published in 2011 by Georgetown University Press

The Treasury Board of Canada Secretariat's Policy on Financial Management Governance, <http://www.tbs-sct.gc.ca/pol/doc-eng.aspx?section=text&id=14005>

The Chief Finance Officer: Role and responsibilities - GOOD PRACTICE GUIDE, published in 2004 by the Auditor General of Victoria, http://download.audit.vic.gov.au/files/cfo_gpg.pdf

Association of Government Accountants' Annual CFO Survey – July 2011, by the Association of Government Accountants, the National Association of State Auditors, Comptrollers and Treasurers and Grant Thornton
<http://www.agacgfm.org/AGA/Documents/Research/2011AGACFOSurveyReport.pdf>

The Chief Financial Officers Act of 1990—20 Years Later, published in July 2011 by the Chief Financial Officers Council, and the Council of the Inspectors General on Integrity and Efficiency,
<http://www.whitehouse.gov/sites/default/files/omb/financial/cfo-act-report.pdf>

Your Community with Financial Planning, published in 2007 by Public Management and written by the Government Finance Officers Association, <http://www.gfoa.org/downloads/ICMALTFPArticle.pdf>

Building a Financial Resilient Government through Long-term Financial Planning, published in 2009 by the Government Finance Officers Association
<http://www.gfoaconsulting.org/downloads/GFOAWhitepaper-Resiliency.pdf>

Best Practice - Long-Term Financial Planning published in 2008 by the Government Finance Officers Association
<http://www.gfoa.org/downloads/LongtermFinancialPlanningFINAL.pdf>

The National Audit Office's Financial Management Maturity Model
http://www.nao.org.uk/help_for_public_services/financial_management/fmmm.aspx

The Certified Institute of Public Finance and Accountancy's Financial Management Model
<http://www.gfoa.org/downloads/GFRJune2005.pdf>

Sound Transit's 2012 Financial Plan
http://www.soundtransit.org/Documents/pdf/about/financial/2012/2012_FinancialPlan.pdf

Creating Value Through World-class Financial Management, published in 2000 by the Government Accountability Office <http://www.gao.gov/special.pubs/ai00134.pdf>

Boeing's Current Market Outlook 2012-2031
<http://www.boeing.com/commercial/cmo/index.html>

Appendix B

State of Washington Budgeting, Accounting and Reporting System Act Powers and Duties of State Officers and Agencies

RCW 43.88.160

Current Law and Legislative History

As of October 19, 2012

Background.

One of the most significant achievements of the Rosellini administration (1957-1965) was the passage of the Budget and Accounting Act of 1959. It establishes the expectation for comprehensive, efficient financial accounting and reporting and efficient public management in the state.

Prior to passage of the Act, state officials had grappled with the archaic and outmoded patchwork of systems that regulated or tracked government expenditures and sources of revenue. The Legislature's approval of the Budget and Accounting Act of 1959 ended a ten-year bipartisan effort to overhaul the state's fiscal system.

One of the most significant reforms addressed by the Act was newly established powers and duties of key officers and agencies. On March 10, 1959, *The Seattle Times* urged the Washington Senate to approve the Act, which was done the following day. In its statement, *The Seattle Times* said "The state can ill afford another two years of operating in its present fiscal maze—under a wasteful system which no modern private business would tolerate." The genesis and history of The Budget and Accounting Act may be found at https://apps.leg.wa.gov/oralhistory/timeline_event.aspx?e=36

Current Law.

The following outlines the current major fiscal responsibilities of the Governor, Director of the Office of Financial Management, Treasurer, Auditor and Joint Legislative Audit and Review Committee. The date of origin for each responsibility is indicated in red.

- **Governor, through the Director of Office of Financial Management, shall:**
 - Devise and supervise a modern and complete accounting system for each agency to the end that all revenues, expenditures, receipts, disbursements, resources, and obligations of the state are properly and systematically accounted for. **1959**
 - Adopt and periodically update an accounting procedures manual. **1981**
 - Establish central accounts in the Office of Financial Management at the level of detail deemed necessary by the Director to perform central financial management. **1959**
 - Report quarterly on primary operating budget drivers such as applicable workloads, caseload estimates, and appropriate unit cost data, relying on the official forecasts of the Caseload Forecast Council. **1997 1981**
 - Report at least annually on the status of all appropriated capital projects, including transportation projects. **1991**
 - Cause corrective action to be taken on audit findings issued by the State Auditor's Office within six months; report annually on the status of audit resolution. **1998**

- Develop and maintain a system of internal controls and internal audits in each agency that will:
 - Safeguard its assets,
 - Check the accuracy and reliability of its accounting data,
 - Promote operational efficiency, and
 - Encourage adherence to prescribed managerial policies for accounting and financial controls. 1993
- Make surveys and analyses of agencies with the objective of determining better methods and increased effectiveness in the use of manpower and materials, and authorizing employee training. 1959
- Establish policies for contracting for child care services. 1993
- Identify and report on duplication of effort or lack of coordination among agencies. 1959
- Review any pay and classification plans for fiscal impact. 1959
- Fix the number and classes of positions or authorized employee years of employment for each agency. 1959
- Adopt rules necessary to carry out duties and responsibilities. 1959
- **The Treasurer shall:**
 - Receive and disburse all public funds of the state not expressly required by law to be kept by some other persons; exempts higher education institutions. 1959
 - Keep a correct and current account of all moneys received and disbursed. 1959
 - Coordinate agencies' acceptance and use of credit cards and other payments methods. 1993
- **The State Auditor shall:**
 - Report to the legislature the results of current post audits that have been made of the financial transactions of each agency. 1959
 - Give information to the legislature at any time on any subject relating to the financial affairs of the state. 1959
 - Report annually on or before the 31st of December on whether agencies, in making expenditures, complied with the laws of the state. 1959
 - Perform or participate in performance verifications and audits using de minimis resources or as expressly authorized in the state's budget or the performance audit work plan approved by the joint legislative audit and review committee. 1996
 - Take exception to specific expenditures that have been incurred by any agency or take exception to other practices related in any way to the agency's financial transactions and to cause such exceptions to be made a matter of public record. 1959
 - Report any irregularities to the attorney general. 1959
 - Investigate improper government activity under Chapter 42.40 RCW. 1982
 - Conduct comprehensive performance audits of state and local government under Initiative Measure No. 900, approved November 5, 2005. 2006
- **The Joint Legislative Audit and Review Committee may:**
 - Make post audits of the financial transactions of any agency and management surveys and program reviews as well as performance audits and program evaluations. 1959
1971 1993
 - Give information to the legislature at any time on any subject relating to the performance and management of state agencies. 1975
 - Make a report to the legislature which shall include at least the following:
 - Determinations as whether state agencies in making expenditures have complied with state laws.
 - Exceptions to specific expenditures or the financial practices of any agencies.

- Recommendations for improving the state's credit, for lessening expenditures, for promoting frugality and economy in agency affairs, and generally for an improved level of fiscal management. **1959**

Legislative History.

The following outlines the significant legislative history of RCW 43.88.160—fiscal management—powers and duties of officers and agencies (1959 to present):

- **2006—Chapter 1—Performance Audits of Government Entities (Initiative 900)**
 - Authorizes the State Auditor to conduct comprehensive performance audits of state and local governments.
 - Provides independent funding stream to pay for the audits.
- **1998—Chapter 135—State Audit Resolution**
 - Directs Director of OFM to cause corrective action to be taken on financial audit findings within six months.
 - Requires annual reporting on the status of audit resolution.
- **1997—Chapter 168—Caseload Forecast Council**
 - Establishes six-member Caseload Forecast Council in the Executive Branch (two from House, two from Senate and two appointed by the Governor).
 - Oversees the preparation and approval of all official state caseload forecasts.
 - Requires OFM Director to use the work of Caseload Forecast Council.
 - Defines “caseload” to mean the number of persons expected to meet entitlement requirements and require the services of public assistance programs, state correctional institutions, state institutions for juvenile offenders, the common school system, long-term care, medical assistance, foster care, and adoption support.
- **1996—Chapter 288—Performance Audits**
 - Authorizes the State Auditor to perform or participate in performance audits using de minimis resources or as expressly authorized in the state's budget or in the work plan of the joint legislative audit and review committee.
- **1993—Chapter 500—Credit Cards**
 - Authorizes the State Treasurer to coordinate agencies' acceptance and use of credit cards and other payments methods.
- **1993—Chapter 406--Performance-Based Government Act of 1993**
 - Requires Director of OFM to develop and maintain a system of internal controls and internal audits in each agency.
 - Authorizes the Joint Legislative Audit and Review Committee to conduct performance audits and program evaluations.
- **1993—Chapter 194--Contracting of Child Care Services**
 - Requires Director of OFM to establish policies for allowing the contracting of child care services.
- **1991—Chapter 358--Reporting on Status of Appropriated Capital Projects**
 - Requires the Director of OFM to report at least annually on the status of appropriated capital projects.

- **1981—Chapter 270--State Accounting Procedures Manual and Reporting on Operating Budget Drivers**
 - Requires the Director of OFM to adopt and periodically update an accounting procedures manual.
 - Fixes responsibility with Director of OFM to report quarterly on primary budget drivers such as workloads, caseload estimates, and unit cost data.

- **1975—Chapter 293, 1st ex.session--Joint Legislative Audit and Review Committee's (JLARC) Authority**
 - Authorizes JLARC to give information to the legislature whenever required related to “performance and management” of state agencies; prior language referred to “financial affairs” of state agencies.

- **1971—Chapter 170, 1st ex.session--Performance Audits, Management Surveys and Program Reviews**
 - Prohibits the State Auditor from conducting performance audits.
 - Vests exclusive authority for performance audits with the Joint Legislative Audit and Review Committee.
 - Authorizes the Joint Legislative Audit and Review Committee to conduct management surveys and program reviews.

- **1959—Chapter 328—State Budget and Accounting Act of 1959**
 - Establishes newly defined fiscal powers and duties of state officers and agencies.

