Chapter Four: Money

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IBM CENTER FOR THE BUSINESS OF GOVERNMENT
WASHINGTON, DC 20005

MEMORANDUM FOR THE HEADS OF EXECUTIVE DEPARTMENTS AND AGENCIES

SUBJECT: **Money**

In the federal government, the budget process is not simply a bean-counting game. The budget process shapes policy—and it inevitably reduces all decisions down to a dollar denomination. The process, including upfront strategic and long-range planning and performance targets, is where policy and strategic decisions are made in the federal government.

Obtain Resources in a Challenging Environment

Resources will be scarce, and the way in which they are allocated and used is crucial to you and your organization's overall effectiveness. The fiscal pressures on the U.S. government, particularly on discretionary spending, are unsustainable. The sources of revenue and range of options for funding new initiatives are becoming broader and more complex. A solid financial strategy can no longer be an afterthought, cobbled onto a policy proposal or developed as part of an after-the-fact business plan, if at all. Understanding costs and measuring program performance are critical to effective decision making and need to be part of the policy and program development process.

One of the secrets that only the initiated know is that budget numbers are the keys to the doors of everything. Spending for everything the government does—whether it is foreign aid, biomedical research, or education—and revenues from every source are all reflected, recorded, and battled over in numbers. And the sum of those numbers, and who gets how much, is fiscal and economic policy. If it matters, there are numbers that define it. For that reason, you need to understand the mechanics of the numbers process. And you have to give these resource numbers meaning—to put them in the proper context at the right time and know what every important player is trying to do to them or with them and the reasons for the different pressures.

Manage the Resources You Receive

Managing money in government is serious business. You can go to jail if you do not do it right. That said, managing resources means more than simply keeping the books straight and helping to ensure that funds are not misspent. Resources need to be invested and deployed strategically based on reliable, timely, high-quality information that helps policy makers and program officials make difficult choices in a highly complex environment. Understanding costs and measuring program performance are critical to effective decision making and need to be part of the policy and program development process.

By and large, starting with the Chief Financial Officers Act of 1990, financial management legislation has focused more on government-wide reform—particularly developing government financial standards, applying private sector financial standards and processes to the federal sector, aligning spending and performance, and reducing the size of government and competing federal functions that are commercial in nature. Consequently, federal financial management has been elevated to a more sophisticated platform.

While legislation has been put into place to strengthen the role of the federal chief financial officer (CFO), there is a lack of clarity for federal CFO roles and responsibilities. Oversight responsibilities for CFOs in the federal government vary from agency to agency. While CFOs are responsible for the financial management activities of their agency, not all CFOs are responsible for budgeting and planning. Similarly, some CFOs share responsibility for implementation of financial management systems with their agency chief information officer (CIO). Moreover, in some agencies, the CFO is responsible for many other agency activities, including human resources, asset management, procurement, facilities, bankcards, and general administration in addition to financial management. In some agencies, the CFO also reports to the CIO. In other words, there are no standard practices for federal CFO responsibilities.

Show Results from What You Spend

You and your organization will be under increasing pressure to produce—and to demonstrate—results in terms of your goals and mission. Integrating performance and results with decision making for budget resources has long been a goal of the U.S. federal government. During the past decade, Congress and the executive branch have increased their emphasis on improving management across all departments and agencies. A series of legislative proposals and changes to federal budget guidance have highlighted the presentation of performance and results information for the annual investment of public dollars. The Government Performance and Results Act (GPRA) of 1993 was first implemented on a government-wide basis in 1997 with the fiscal year 1999 budget. GPRA seeks to fundamentally change the focus of federal management and accountability from a preoccupation with inputs and processes to a greater emphasis on the outcomes and results that programs should be achieving. It brings together managers, workers, and stakeholders to focus on: (1) the purposes of programs; (2) the means to achieve them; and (3) progress toward achievement.

As noted in the *Memo on Performance*, you are coming into government at a time when much progress has been made on obtaining and using performance management information for government decision making. Initiatives have been launched to more effectively link budget and performance. George Washington University's Philip G. Joyce writes, "The federal government has never been in a better position to make its budget decisions more informed by considerations of performance."

A focus on results and outcomes can help enhance government's capacity to assess competing claims for budgetary resources by arming decision makers with better information both on the results of individual programs as well as on entire portfolios of policies and programs addressing common goals. The use of performance information is not an end in itself, but rather a means to support better decision making and lead to improved performance and accountability. While performance budgeting will never resolve the vexing resource trade-offs involving political choice, it does hold the promise of modifying and informing policy decisions and resource allocation by shifting the focus of debate from inputs to the program outcomes and results that are crucial to an organization's success and to the nation's security.

Linking Resources to Results

Question: Instead of making budget decisions based on past level of support, is there a way to inject performance information into the budget process?

Answer: The goal of "budget and performance integration" has received much attention in recent decades. Your challenge is to prepare a budget that includes performance information, which you forward to the Office of the Secretary in your department, which forwards it to the Office of Management and Budget (OMB). The budget preparation stage begins with the initial planning undertaken by your agency, which can start a year or more prior to the submission of the budget request to Congress. Instructions from OMB on budget preparation (OMB Circular A-11) state that the budget request should be informed by your judgment "regarding the scope, content, performance and quality of programs and activities proposed to meet the agency's mission, goals and objectives." In recent years, the expectation has increased that budget formulations within federal agencies are to be informed by performance considerations.

In his report to the IBM Center, George Washington University's Philip Joyce writes that agency heads can now use a variety of tools and measures to make their budget request more focused on performance. Joyce writes, "Making budget development more focused on performance normally requires that the agency budget office develop some framework for budget requests that clarifies the relationship between costs and performance." Joyce explains that these budget requests should include:

- **A strategic and performance context.** Since the enactment of the Government Performance and Results Act (see page 81), agencies are expected to have articulated some strategic vision. Joyce writes, "This means that budget requests should be presented in the context of their effects on the strategic priorities of the agency, normally established in the agency strategic plan." There should be a clear connection, states Joyce, between what the agency "does" on a day-to-day basis and its larger strategic and performance objectives.
- **Performance information.** As discussed in the section on Performance, agencies should have output and outcome measures that indicate the agency's success in meeting its objectives.
- **Cost information.** "The budget request should identify the true cost of providing services.… This will not be possible without some relatively sophisticated means of allocating overhead or indirect costs," contends Joyce. (For further discussion on developing cost information, see pages 80–81.)

Thus, the key to linking performance to your agency's budget is the availability and use of performance measures. According to Joyce, you can use this performance information to:

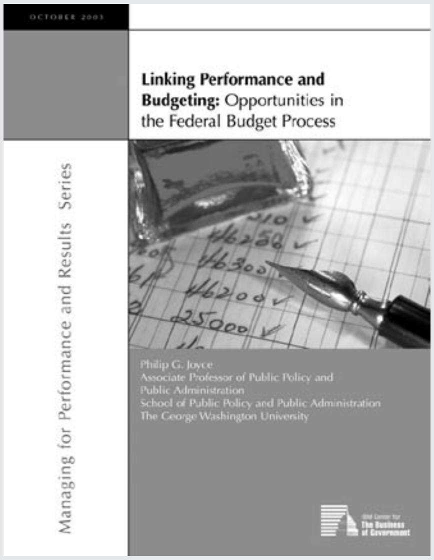
- Build your budget justification for submission to the department.
- Make trade-offs between your agency's programs to allocate funds strategically.
- Determine the productivity of your agency programs.
- Determine overlapping services within your agency.
- Determine in-house versus contractual production of services.

Contrasts Between Traditional Views of Budgeting and Performance-Informed Budgeting

From *Linking Performance and Budgeting: Opportunities in the Federal Budget Process*
by Philip G. Joyce

Performance-informed budgeting exists in a context of more traditional input-focused efforts to allocate resources. This input focus has historically been less on results and more on incremental levels of funding. The first table below presents a contrast between traditional budgeting and performance-informed budgeting. It is important to keep in mind, however, that while performance-informed budgeting is probably unattainable, by the same token "traditional" budgeting, as described, is overly stylized. They are best viewed as ends on a continuum rather than discrete options.

The second table below presents the various stages in the budget process in which performance-informed budgeting can be applied.



Traditional vs. Performance-Informed Budgeting

Traditional Budgeting	Performance-Informed Budgeting
Inputs as ends in themselves	Relationship between inputs and results
Changes in inputs at the margin (for example, how many more dollars than last year)	Changes in inputs and results for the entire program (for example, how much more results for how much more money)
Divorced from planning and management in agencies	Budgeting integrated with planning and management
Budgeted resources	Costs

Stages of the Federal Budget Process

Stage of Budget Process	Description of Activities	End Product
Budget Preparation—Agency	Agency preparation of a budget for submission to OMB	Budget request
Budget Preparation—OMB	Analysis of agency budget request on behalf of the president; negotiation with agencies on budget allocation levels	President's budget
Budget Approval—Congress	The Congress makes overall fiscal policy, authorizes programs, and appropriates funds	Budget resolution, authorization bills, appropriation bills
Budget Approval—President	Action on congressional legislation affecting budget	Signature or veto
Budget Execution	Implementation of programs by federal agencies; allocation of dollars by agency subunit	Administration of programs
Audit and Evaluation	Review of tax and budget actions after the fact; recommendations made for changes	Audits and evaluations

Accounting for Costs

Question: My agency, like many other government agencies, is going to have to control its spending more tightly over the next several years. Do you have any suggestions on how we might better control our costs?

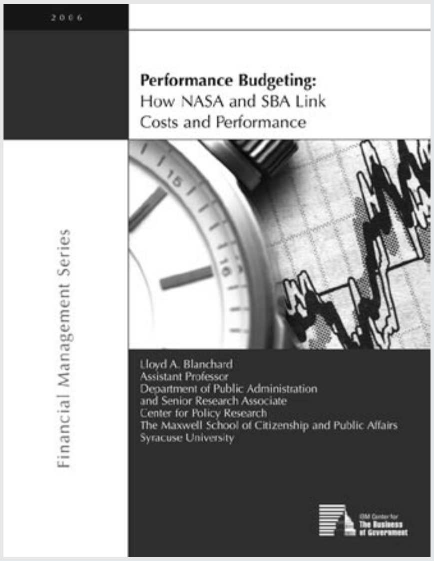
Answer: During one of your first conversations with your chief financial officer, you should probe the extent to which (or whether) your agency is able to measure the costs of its operations and programs. The truth of the matter is that very few federal agencies are able to capture and report the full costs of their major operations. In describing cost management in his report to the IBM Center, Louisiana State University's Lloyd Blanchard writes, "The cost management function of financial management systems is where costs are matched with activities and outputs. The level of sophistication of this function within the financial system is dependent on the operational nature of the programs involved, but … four basic functions must be present: cost recognition, cost accumulation, cost distribution, and a working capital fund." The key here is linking costs to specific activities and outputs.

Based on his analysis of cost accounting practices in two federal agencies—the Small Business Administration and the National Aeronautics and Space Administration—Blanchard sets forth recommendations for agency heads who desire to improve their cost accounting policies and procedures:

- **Align performance, costs, and accounts.** In order to accomplish this, you will need to ask your agency to carefully align, or map, major program activities to one or more of the strategic goals of the agency. This will entail: (1) synchronizing program performance measures with mission and strategic goals; (2) synchronizing program costs with the program performance measures; and (3) negotiating with your appropriations committee to better align Congress's appropriation account structures to your agency's budget structure.
- **Build outcome-based measures for ideal cost-performance integration.** By developing effectiveness, cost, and efficiency measures, you and your management team will be able to understand more precisely the relationship between budget costs and performance.
- **Develop a cost allocation method that fits the organizational design.** Your organization will need to clearly identify: (1) programs that provide direct services; and (2) non-program activities that will be the basis for your indirect cost categories.
- **Supplement existing systems to support performance costing.** This will be a challenge, but is crucial to the ultimate success of this initiative. Blanchard writes, "Agencies should start modestly and improve budget-performance integration capacity over time. The biggest reason for such an approach is the cost of implementing new cost accounting systems to handle the tasks required of good cost management."
- **Create incentives to improve effectiveness and efficiency.** As an agency head, you can do this. Experience has shown that agency head involvement and support is one of the keys to successful implementation of performance budgeting. At NASA, the agency head gave program managers authority over the use of their personnel. Blanchard writes, "By making direct personnel costs the program's responsibility, and not a separate budgeting line item, NASA created an incentive for program managers to reveal their true need for personnel resources.… In general, full cost at NASA creates the incentives for program and support managers to behave more as market-based producers, revealing their true need for certain resources, and paying for what used to be 'free' from a budgetary standpoint."

Statutory Foundations of Cost Requirements

From *Performance Budgeting: How NASA and SBA Link Costs and Performance*
by Lloyd A. Blanchard



As described below in "Key Legislation," the modern statutory framework for costing performance budgets … starts with the Chief Financial Officers (CFO) Act of 1990 and the Government Management Reform Act (GMRA) of 1994. While these laws established the CFO function and position in federal agencies, the CFO Act calls for the "development and reporting of cost information" and instructs the CFO to regularly review "fees, royalties, rents, and other charges" for services provided and "make recommendations on revising those charges to reflect costs incurred." Congress has long been concerned about the lack of sophisticated financial management practices in the federal government, stating the following as a rationale for the bill:

> Current financial reporting practices of the federal government do not accurately disclose the current and probable future cost of operating and investment decisions, including the future need for cash or other resources, do not permit adequate comparison of actual costs among executive agencies, and do not provide the timely information required for efficient management of programs.

Key Legislation

Chief Financial Officers Act of 1990 (CFO Act)
Created the deputy director for management position and the Office of Federal Financial Management (with head as comptroller) at OMB, and established federal financial management and related system policies and requirements. Created agency CFO and deputy CFO in 24 agencies, and required them to develop and maintain integrated financial management systems; and direct, manage, and provide policy guidance and oversight of all agency financial management personnel and operations.

Government Performance and Results Act of 1993 (GPRA)
Required all agencies to set strategic goals, measure performance, and report on the degree to which goals were met. Required an annual performance plan that provides a direct linkage between the strategic goals and employees' daily activities. Required an annual report on program performance for the previous fiscal year, and in each report, the agency is to review and discuss its performance compared with the performance goals it established in its annual performance plan.

Government Management Reform Act of 1994 (GMRA)
Required all agencies covered by the CFO Act to have agency-wide audited financial statements, required a government-wide audited financial statement, allowed agencies to consolidate various financial and performance reporting requirements into a single report with a common reporting deadline, and extended the CFO Act to all agencies.

Federal Financial Management Improvement Act of 1996 (FFMIA)
Required agencies to implement and maintain financial management systems that comply substantially with federal financial management systems requirements, applicable accounting standards, and the United States Government Standard General Ledger at the transaction level.

Source: *GAO. 1998.* Managing for Results: The Statutory Framework for Performance-Based Management and Accountability. *GAO/GGD/AIMD-98-52.*

Creating a Culture of Cost Management

Question: I understand that moving from a "budget control" culture to a "cost management" culture is a major change. Can you tell me more about creating a "cost management" culture?

Answer: In their report to the IBM Center, Michael Barzelay and Fred Thompson present a case study of how General George T. Babbitt transformed the Air Force Materiel Command (AFMC) from an organization driven by "budget management" to one focused on "cost management." The goal of General Babbitt, according to Barzelay and Thompson, was to increase "the institution's capacity to manage costs, with potential benefit felt indefinitely if reinforced by his successors." Barzelay and Thompson describe the differences between the two cultures:

Budget Management Culture

- Focus on inputs
- Secure bigger budgets and more spending authority
- Spend everything (execute full obligational authority by the end of the fiscal year)
- Centralize budget decisions

Cost Management Culture

- Focus on accomplishments
- Cut budget/maximize productivity
- Understand costs (avoid expenses where possible)
- Decentralize decisions to those best situated to maximize productivity

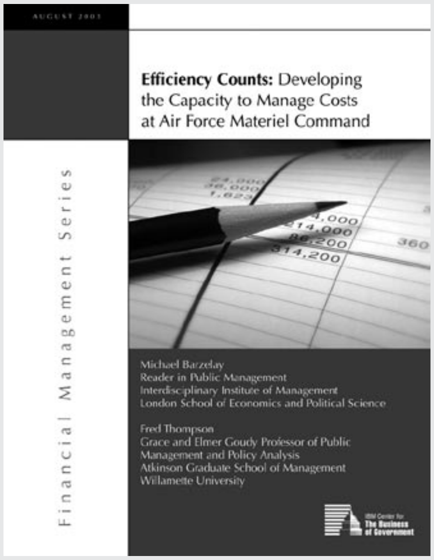
General Babbitt concluded that in a time of declining resources for his command, it was necessary for the organization to get better control of its spending and costs. Barzelay and Thompson write, "He [Babbitt] foresaw the command increasingly losing control of its destiny as its overseers sought ways to reduce AFMC's resources in the name of paring infrastructure. His experience told him that the command had not developed the orientation, motivation, and tools to become more efficient, leaving AFMC extremely vulnerable to arbitrary budget cutting and mission failure over the medium and long run."

Based on their analysis of the experience of General Babbitt at the Air Force Materiel Command, Barzelay and Thompson conclude that there are six major steps involved in moving toward a cost culture:

- **Organizing participation in the intervention.** This step involves developing a broad-based commitment within the organization to manage costs.
- **Making sense of costs.** This is a crucial step in which managers develop ideas about what can be done to improve the relationship between benefits and costs within the organization.
- **Reordering relations with authorizing constituencies.** This step involves changes in the rules and procedures within the organization so that existing rules concerning expenditure planning and financial management are modified to permit more effective cost management.
- **Practicing performance planning.** This step involves managers within the organization gaining firsthand experience with cost management. The goal is to strengthen an organization's aspirations for achievement and willingness to correct organizational weaknesses as well.
- **Practicing execution control.** The essence of this step involves managers learning how to undertake corrective action as part of the delivery or execution process.
- **Stabilizing the practice.** This step is important because a serious practice of cost management is vulnerable to collapse, especially when institutional leadership passes from one individual to another. This step involves providing a secure footing for ideas, people, and organizational arrangements for the continuation of the cost control culture over time.

Developing the Capacity to Manage Costs

From *Efficiency Counts: Developing the Capacity to Manage Costs at Air Force Materiel Command* by Michael Barzelay and Fred Thompson



Cost management can be viewed in terms of the authority of managers to acquire assets and the kinds of financial targets that would align responsibility with authority:

- *Discretionary expense center managers* are accountable for compliance with an asset acquisition plan (expense budget). They have no independent authority to acquire assets. Their superiors must authorize each acquisition. Managerial accountants generally believe that a unit should be set up as a discretionary expense center only when there is no satisfactory way to match its expenses to final cost objects. Most governmental organizations are discretionary cost centers.
- *Cost center managers* are responsible for producing a stated quantity and/or quality of output at the lowest feasible cost. Someone else within the organization determines the output of a cost center—usually including various quality attributes, especially delivery schedules. Cost center managers are free to acquire short-term assets (those that are wholly consumed within a performance measurement cycle), to hire temporary or contract personnel, and to manage inventories.
    1. In a standard cost center, output levels are determined by requests from other responsibility centers, and the manager's budget for each performance measurement cycle is determined by multiplying actual output by standard cost per unit. Performance is measured against this figure—the difference between actual costs and the standard.
    2. In a quasi profit center, performance is measured by the difference between the notational revenue earned by the center and its costs. For example, let's say a hospital's department of radiology performed 500 chest X-rays and 200 skull X-rays for the department of pediatrics. The notational revenue earned was $25 per chest X-ray (500) = $12,500 and $50 per skull X-ray (200) = $10,000, or $22,500 total. If the radiology department's costs were $18,000, it would earn a quasi-profit of $4,500 ($22,500 minus $18,000).
- *Profit center managers* are responsible for both revenues and costs. Profit is the difference between revenue and cost. Thus, profit center managers are evaluated in terms of both the revenues their centers earn and the costs they incur. In addition to the authority to acquire short-term assets, to hire temporary or contract personnel, and to manage inventories, profit center managers are usually given the authority to make long-term hires, set salary and promotion schedules (subject to organization-wide standards), organize their units, and acquire long-lived assets costing less than some specified amount.
- *Investment center managers* are responsible for both profit and the assets used in generating profit. Thus, an investment center adds more to a manager's scope of responsibility than does a profit center, just as a profit center involves more than a cost center. Investment center managers are typically evaluated in terms of return on assets (ROA), which is the ratio of profit to assets employed, where the former is expressed as a percentage of the latter. In recent years, many have turned to economic value added (EVA), net operating "profit" less an appropriate capital charge, which is a dollar amount rather than a ratio.

Managing Risk in Federal Credit Programs

Question: I understand that my agency has a number of credit programs that provide loans and loan guarantees. What are some best practices regarding risk management that I should consider?

Answer: While the use of credit as a "tool" of government has expanded in recent years, the last decade has also brought an expansion of information technologies that can be used in assessing the risks involved in your agency's credit portfolio. In his report to the IBM Center (2005), Johns Hopkins University's Tom Stanton concludes that each stage of the credit management cycle—loan origination, servicing, monitoring of lenders or other private parties, loss mitigation, and default management—has benefited from the development of a broad array of approaches that are applied based on analysis of information databases.

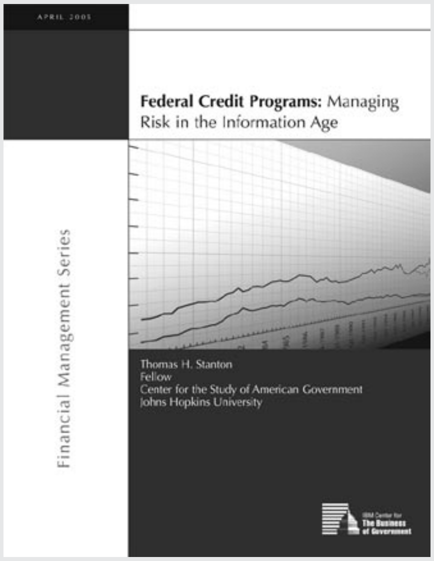
Stanton concludes that these new technologies provide new opportunities for the federal government in regard to credit programs. He writes, "Opportunities occur as federal credit agencies increasingly develop risk management systems that might have been unavailable or unaffordable in the past. These risk management systems often are based on improved business processes as well as the application of new technologies to those processes."

In his report, Stanton recommends that you:

- **Develop a process to analyze pertinent information about the nature and dimensions of risks of each of your loan programs.** The first step in effective risk management, according to Stanton, is to be able to assess program risks systematically and on a continuing basis. This requires development of an ongoing process to gather, quantify, and evaluate information about risks.
- **Create a risk management office responsible for creating and overseeing effective risk management systems and for reporting important risk issues to top agency management.** Such an office will assist you in effective risk detection and assessment. The major task of this office will be to ensure that you always have a clear picture of the risks inherent in the programs you manage.
- **Require that your risk management office prepare regular and special reports concerning significant risk factors and the state of your agency's program and portfolio.**
- **Establish a credit committee, or a similar body, which you will chair to review risk-related information regularly.** This committee will grapple with the trade-offs that must be made between program development, on the one hand, and protection of the program from unacceptable risks and surprises, on the other.
- **Review the ability of your agency to address major forms of risk that potentially could emerge and determine if you need additional tools or regulations.** Based on this review, you might conclude that additional enforcement tools may be needed to address program partners that create unacceptable risks. You might also conclude that it is necessary to issue new regulations or amend guaranty agreements with lenders or take other steps to improve the agency's position in the event serious risk problems do emerge.

The Size and Scope of Federal Credit Programs

From *Federal Credit Programs: Managing Risk in the Information Age* by Thomas H. Stanton



The federal government provides loans or loan guarantees as a way to encourage funding for borrowers or activities that are considered important. Credit is one of a range of tools that government may use to achieve public purposes. As with the other tools of government, credit programs must be carefully matched with the public purposes that they are supposed to serve. The U.S. government extends credit for a broad range of purposes, from overseas activities to the needs of people caught in a disaster. In appropriate circumstances, it can be extremely effective to extend government credit to borrowers who are capable of using the funds and then repaying their debt obligations; by contrast, provision of credit to borrowers who are not creditworthy can be costly both to the government that must take the losses on the defaulted loans and to the borrowers themselves.

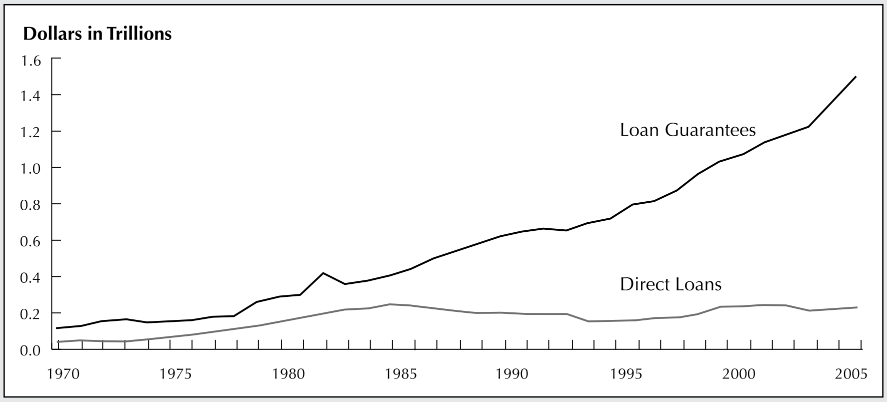
The federal government borrows money to fund direct loans and provides loan guarantees that are backed by the full faith and credit of the U.S. Treasury. Given the financial strength of the U.S. government, the federal government thus can maintain very large direct loan and loan guarantee programs.

The figure below shows the volume of federal direct loans and loan guarantees outstanding in recent decades. Over the past 20 to 30 years, the volume of federal loan guarantees has grown significantly, while the volume of direct loans outstanding has remained at a more constant level.

The figure captures several trends. First, starting in the late 1960s, the government greatly expanded federal credit programs. The federal government responded to urban unrest with new Federal Housing Administration mortgage insurance programs, both for single-family homes and for apartment buildings. Many of these programs involved heavily subsidized interest rates, as a way of helping to lower housing costs for low-income home buyers and renters. The government created the guaranteed student loan program in 1965 and greatly expanded its coverage in subsequent years. Credit programs of the Farmers Home Administration (now succeeded by the Rural Housing Service) multiplied sixfold in outstanding volume between 1973 and 1984, to $61 billion. This resulted from more generous loan terms and also from an expansion of the types of loan program that the agency offered.

For federal credit programs, budget constraints caused a shift to loan guarantees rather than a constriction in the actual volume of credit outstanding.

Face Value of Federal Credit Outstanding (FY 1970 to FY 2005)



Source: Budget of the United States Government: Analytical Perspectives, Fiscal Year 2006, *Chart 7-2, p. 108 (February 2005).*

Managing Federal Assets

Question: I understand that my agency owns some buildings and might have other assets. What can I do to improve my agency's asset management activities?

Answer: The first step is to understand exactly how many assets your agency is now holding. Assets include real property (buildings), financial assets, personal property, and fleet assets. The federal government, as a whole, now owns over 440,000 buildings. Financial assets include accounts receivable, such as tax debts, defaulted federal loans, and outstanding direct loans.

There are three major actions that you can take to improve asset management in your organization:

- **Adopt a portfolio strategy.** The current problem is that many agencies, perhaps your own, treat their federal assets on an individual basis rather than addressing the whole portfolio of assets and managing them through a comprehensive strategy. In the area of financial assets, Tom Stanton found, as noted in his report to the IBM Center (2003), that the Small Business Administration "took a comprehensive look at its business loan guarantee program and determined that sales of nonperforming loan assets could save considerable resources that the agency then could use more productively to further its mission of supporting small businesses."

  The Public Building Services (PBS) of the General Services Administration developed a portfolio strategy to respond to the problem of scarce resources for property maintenance. The goal of the strategy was to restructure its portfolio to consist primarily of strong income-producing properties. According to Stanton, this enabled PBS to limit expenditures on marginal assets, concentrate resources on performing assets, and improve the quality of its space.

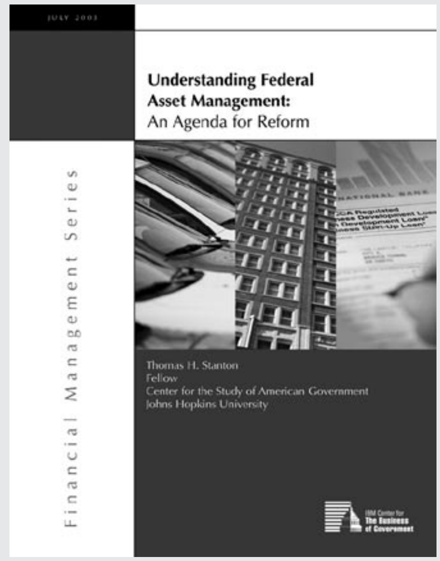
- **Adopt a life-cycle approach to managing federal assets.** By using this approach, federal agencies plan for the operations, support, and disposal costs associated with government assets, starting before asset acquisition and continuing through the life of the asset. Stanton observes, "It is not unusual for maintenance costs of an asset to far exceed the initial acquisition costs or for unanticipated servicing costs to exceed the value of the asset." In the area of loans, it is much less expensive to take early actions to forestall loan defaults than it is to try to restructure or foreclose on poorly originated or serviced loans when borrowers fail to make the payments.

  A key element of an asset life-cycle approach is to develop a specific plan for each stage. For example, the first stage is the development of an Asset Strategy, which includes the overall direction of the asset base—whether to outsource, or to dispose of the assets or to increase the asset base, or to improve reliability. From the Asset Strategy, an Asset Plan is developed to execute the strategy and requires having a good accounting and status of the existing asset base. Other stages include the Evaluate/Design phase, the Acquire/Construct phase, the Operate/Maintain phase, the Modify phase, and finally the Disposal phase. In each phase, the asset has different characteristics or requirements which necessitate different asset management strategies, processes, and technology solutions.

- **Outsource the asset management function to the private sector.** In some cases, it may be more efficient to transfer an agency's assets to a private entity that would then take over the asset management function. In this case, the agency establishes performance metrics on the manager of the portfolio and rules on how the portfolio is to be managed. The agency does not manage the assets in the portfolio, although it can direct how those assets are to be managed. For example, a portfolio of loans might be sold to a financial institution that might be able to manage the portfolio more efficiently than the government. The terms and conditions of the loans would not be changed.

Management of Federal Assets Today

From *Understanding Federal Asset Management: An Agenda for Reform* by Thomas H. Stanton



Management of many federal assets today is characterized by (1) disinvestment of government, (2) a growing discrepancy between the nature of assets in an agency's portfolio and the needs of that agency's mission, (3) acquisition of federal assets without consideration of the costs and effort to maintain and eventually dispose of the assets, and (4) statutory requirements that impede effective asset management.

Disinvestment results when the government fails to invest adequate amounts of money in the staff, systems, and facilities that agencies require to manage their programs well. Budget and staff cuts have reduced the management capabilities of many agencies. One agency after another faces an increasing disconnect between growing duties and mostly static resources.

For asset management, this means that many federal agencies may lack the capacity that is needed to manage assets in the most cost-effective manner. For buildings and real property, this means that federal agencies often lack the kinds of information needed to make sound decisions about their asset portfolios. For financial assets, the government may lack the capacity to originate, service, and collect on loans, especially where improvements might require the installation of the types of systems that support comparable private sector activities. Another consequence of disinvestment is the cost of neglected maintenance and modernization, especially of real and personal property and fleets. When an agency faces budget constraints, property maintenance too often seems easy to defer, compared to the pressures of supporting current operations. Assets such as information systems may become obsolete if they are not regularly modernized, and this too has its costs.

The second issue facing government assets is an increasing divergence between the needs of an agency's mission and the nature of the assets it holds. Again, buildings and real property provide the most striking examples. When an agency's mission changes, it may require quite different assets than it needed before. The case study of Rocky Flats illustrates the asset management problems that confront the Department of Energy now that nuclear weapons production has gone from being a national priority to becoming the focus of mutual reductions with the former Soviet Union. Other agencies find that downsizing or the consolidation of offices can leave them with unused or underutilized assets. Especially after September 11, with increasingly costly security requirements for federal facilities, excess or partially used buildings can be expensive for an agency to maintain.

The third issue relates to statutory and other constraints that impede effective asset management. Federal budget scoring rules are a particular problem. Past reforms, such as the institution of credit budgeting in the 1990s and the creation of the Federal Buildings Fund in the 1970s, brought progress to federal asset management. Now, however, the world has changed. To keep up, the budget scoring rules need to be reviewed once again to address critical deficiencies such as their impact on acquisition of buildings and real estate assets and on asset sales.

Managing Grants

Question: As a major provider of grants, what are the key challenges I will face?

Answer: Grants are an effective tool of government when used and managed well. While the use of grants dates back to the 1800s, they are still important today and their use is increasing. In his report to the IBM Center, George Mason University's Tim Conlan writes that grants are "typically designed to support or augment an existing service or activity that is already being carried out by the recipient, or to encourage the provision of new services or activities."

They do, however, provide management challenges for you and your organization. Conlan presents four challenges regarding grants:

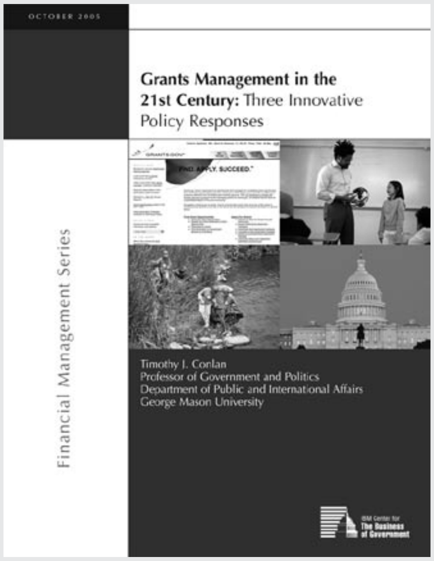
- **Achieving accountability.** The government has long had a fiduciary responsibility to ensure that grant funds are not diverted to corrupt or illegal purposes, spent in racially or other discriminatory ways, or wasted on inappropriate or excessive expenditures. The current challenge is moving beyond legal and financial accountability to performance accountability.
- **Assessing performance.** In order to achieve greater performance accountability, the government will need to develop new ways to assess the performance of grantees. Conlan writes, "The focus on assessing and enhancing the performance of federal grant programs—and federal program activities generally—has grown in recent years." There is now, according to Conlan, an increased demand for higher standards of performance in federal programs, including grant programs.
- **Providing adequate grantee flexibility.** As a manager of grant programs, you will face the challenge of determining how much flexibility is needed (or is not needed) to accomplish the performance objectives of a grant. On the one hand, overly restrictive rules and conditions can be counterproductive to successful implementation and can obstruct innovation and experimentation. On the other hand, too much flexibility might move the project away from its original federal program objectives.
- **Overcoming complexity.** Like much of what we have discussed in this volume, government can get very complicated. There are now over 1,300 individual grant programs, many of which overlap and intersect with each other. There has been some progress in recent years to standardize grants management rules through OMB circulars. Another effective response has been the use of e-grant reforms, including the Grants.gov web portal.

How can you best respond to these challenges? Based on analysis of improvements in the grants arena in recent years, there are two promising innovations which you should consider:

- **Continue movement to the web.** The Grants.gov initiative appears to be heading in the right direction. Additional work can be done to expand this capability to include post-award related activities, as well as simplifying and standardizing report and accountability processes. You should be cautioned *not* to create your own website or another unique database. When possible, you should always strive to align your systems with those of other agencies and not duplicate capabilities that already exist.
- **Use performance partnerships.** A promising practice has been the use of performance partnerships, which are agreements between states and the federal government intended to develop measurable performance goals and standards in the implementation of federal programs in return for greater state flexibility in achieving these objectives. The performance partnership model has been used effectively by the Environmental Protection Agency.

Rationales for Federal Grants-in-Aid

From *Grants Management in the 21st Century: Three Innovative Policy Responses*
by Timothy J. Conlan



There are several reasons for the early use and lasting popularity of the federal grant tool. From a legal and historical perspective, grants-in-aid long were viewed as the most constitutionally permissible means of federal involvement in traditional spheres of state and local responsibility in the early Republic. The scope of the federal government's enumerated powers was one of the most important and contentious political issues in the early Republic. While this issue played out most dramatically in debates over the constitutionality of the Bank of the United States, issues such as the permissible scope of federal involvement in transportation projects and other forms of "internal improvements" were one of the chief causes of conflict between the early political parties.

Grants-in-aid provided a means of finessing this constitutional debate. Grants, first of land and later of cash, could be viewed as constitutionally permissible means of executing accepted federal powers, such as establishing post roads, disposing of and regulating the territories, or spending to promote the general welfare. Although the use of grants in this way remained controversial, the grant tool was clearly less invasive than direct federal administration. As the tool became more and more widely used, grants became a key feature of the shift from "dual federalism," with its sharply demarcated lines of authority between the national government and the states, and the 20th century development of broadly overlapping roles and "cooperative federalism."

Grants also enjoy support for economic reasons. They can, for example, provide an effective way to redress fiscal imbalances in the intergovernmental system. For most of our nation's history, the federal government has enjoyed significant resource advantages vis-à-vis states and localities. In addition, it has historically derived revenues from comparatively productive and efficient forms of taxation. This was particularly evident after enactment of the federal income tax in 1913.

Another economic argument on behalf of grants-in-aid involves the efficiency advantages that grants make possible. Conceptually, grants can allow a closer coincidence between the delivery of public goods and payment for them. In economic theory, public goods and services should be underproduced when those who pay for them do not capture all of the benefits, and they should be overproduced if those who benefit and control production can avoid paying all of the costs for them. One solution to this problem is to provide interjurisdictional grants-in-aid designed to compensate for this fiscal mismatch. An example of this concept was provided by an influential U.S. Treasury Department study in the 1980s: "If 20 percent of the benefits of local police services provided by a city is realized by commuters and visitors to the city from throughout the state, a state matching grant paying 20 percent of the city's total outlays for those services would ensure an appropriate level of provision." Although the empirical evidence that most grants are actually adopted and implemented to serve this function is rather weak, the potential for efficiency gains with grants remains an important rationale for their use.

For Additional Information on Money

Strengthening Homeland Security: Reforming Planning and Resource Allocation (2008) by Cindy Williams

This report presents findings about the organizational structure, processes, and tools that surround planning and resource allocation for homeland security in the executive branch and Congress. The report offers recommendations for consideration by the White House and Congress to improving planning and resource allocation to help leaders establish control over priorities by strengthening the links between strategies and budgets.

Transforming Federal Property Management: A Case for Public-Private Partnerships (2007) by Judith Grant Long

This report examines the potential of public-private partnerships as a response to federal property management issues. This report focuses on the major property-related issues and assesses how public-private partnerships might be used to resolve property management problems, such as excess and underutilized property, deteriorating facilities, and reliance on costly leasing. The report presents a series of recommendations to successfully implement PPPs in the federal government.

Government Garage Sales: Online Auctions as Tools for Asset Management (2004) by David C. Wyld

This report presents examples of how government agencies are succeeding at selling both everyday items and high-end goods via online auctions. Five case studies of online auctioning are presented. The report presents lessons learned and recommendations for government executives to use in making decisions about the management of surplus, seized, or forfeited assets in the public sector via online auctions.

Audited Financial Statements: Getting and Sustaining "Clean" Opinions (2001) by Douglas A. Brook

This report examines the organizational factors and management strategies that affect the ability of federal agencies to generate reliable information for financial statements and achieve unqualified audit opinions. By identifying successful management strategies, the report offers recommendations about how agencies can effectively meet recurring requirements to produce annual audited financial statements.

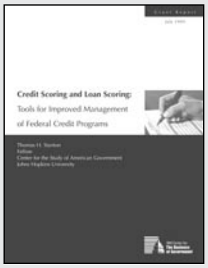
An Introduction to Financial Risk Management in Government (2001) by Richard J. Buttimer, Jr.

This report examines the role of financial risk management techniques in government. The report discusses which private sector financial risk management techniques are best suited for government adoption. The report examines successful financial risk management practices now being used in government and contains a series of recommendations for their future use.

For Additional Information on Money

Using Activity-Based Costing to Manage More Effectively (2000)
by Michael H. Granof, David H. Platt, and Igor Vaysman

This report examines the value of activity-based costing (ABC) for decision making in the public sector. The study shows how activity-based costing can be applied to public sector organizations. The report discusses the feasibility and benefits of applying ABC, as well as the obstacles and limitations in the application of ABC.



Credit Scoring and Loan Scoring: Tools for Improved Management of Federal Credit Programs (1999) by Thomas H. Stanton

This report examines the potential of credit scoring and loan scoring techniques in the federal government. These techniques can be used by federal credit agencies to devise scoring-based database management systems for a broad range of purposes. The federal government currently administers loan and loan guarantee programs that amount to about $1 trillion of credit outstanding. When applied to federal direct loans and guarantees, scoring may help federal credit agencies improve their credit management practices.