



LFUCG Commission on Budget Effectiveness

FINAL REPORT

November 18, 2004

Mission Statement

The Commission on Budget Effectiveness
will evaluate the structure and financial practices of the
Lexington-Fayette Urban County Government

Commission Members

Mira Ball
Phil Holoubek
Ann McBrayer
Pat Price
Phil Roeder (Chair)
Mark Sisk
Mitch Skaggs

UNIVERSITY OF KENTUCKY
DEPARTMENT OF FAMILY PRACTICE AND
COMMUNITY MEDICINE

November 18, 2004

Dear Vice Mayor Scanlon:

On behalf of all the members of the LFUCG Commission on Budget Effectiveness, I am pleased to present our Final Report. The goals of the Commission you appointed in April of this year were: (1) evaluate the structure and financial practices of the LFUCG, (2) make recommendations for increased efficiency, accountability, and financial savings, and (3) identify LFUCG's best financial practices in order to insure their continuity.

We pursued these goals by seeking input from all sectors of the government and the community, gathering financial and budgetary data, applying our judgment to the evaluation of these data, and then making recommendations for improved financial efficiency and accountability.

We were pleased with the support and cooperation from many individuals in the LFUCG and found that LFUCG employees generally are doing the best they can to implement and administer a complex mix of programs and services under significant limitations in planning, budgeting, and IT systems and processes.

Our analysis and proposed improvements focus on weaknesses in structures, systems, and processes that we believe should be addressed quickly and comprehensively. We would be pleased to discuss the issues and our recommendations with members of Council and the Administration as needed.

Sincerely yours,

Phillip W. Roeder
Professor

LFUCG COMMISSION ON BUDGET EFFECTIVENESS
COMMISSION MEMBERS
Mira Ball
Phil Holoubek
Ann McBrayer
Pat Price
Phil Roeder (Chair)
Mark Sisk
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E X E C U T I V E S U M M A R Y

Background

In April 2004, Vice Mayor Mike Scanlon appointed a LFUCG Commission on Budget Effectiveness (CBE).

Objectives

- Evaluate the structure and financial practices of the LFUCG
- Make recommendations for increased efficiency, accountability, and financial savings
- Identify LFUCG's best financial practices to ensure their continuity

Key Findings

LFUCG employees generally are doing the best they can to implement and administer a complex mix of programs and services under significant limitations in planning, budgeting, and IT systems and processes. These limitations include:

- The LFUCG lacks a strategic planning process
- Existing budget process is fragmented and non-strategic
 - The process has three separate budget documents: the Mayor's Proposed Budget, the Council Budget (the official adopted budget), and the Annual Budget
 - The Annual Budget document containing revenue and spending projected out five years does not appear to be a fundamental component used consistently and continually throughout the budget process
- Budgeting and financial reporting is ineffective
 - A comprehensive, integrated focus on performance or results with benchmarking is absent
 - Certain key officials and stakeholders are not continually engaged and communicating throughout the entire budget process
 - No monthly period details are contained in budgets, therefore monthly 'budget vs. actual' comparisons are impossible in financial reports
 - Financial reports are delayed, unreliable, and not user-friendly
- IT system is outdated and ineffective

Key Recommendations

- Implement strategic planning process including vision statement, department mission statements, goals and objectives, and a budget strategy
- Implement a 3-year planning budget process that includes input from all decision makers (commissioners, council, LFUCG staff) on the front end
- Redesign financial reporting system with end-user in mind
- Upgrade/replace IT system and implement a government-wide Enterprise Resource Planning (ERP) system

LFUCG COMMISSION ON BUDGET EFFECTIVENESS

FINAL REPORT

November 18, 2004

INTRODUCTION

In April of 2004, Vice Mayor Scanlon appointed a LFUCG Commission on Budget Effectiveness and asked the Commission to:

- * evaluate the structure and financial practices of the LFUCG
- * make recommendations for increased efficiency, accountability, and financial savings
- * identify LFUCG's best financial practices in order to insure their continuity

The Commission on Budget Effectiveness (CBE) has pursued each of these tasks using a variety of methods. Over the past seven months, the Commission interviewed members of the Urban-County Council and the administration, reviewed and evaluated numerous LFUCG financial and budgetary documents, assessed budget and financial practices in other governments and in the private sector, and considered recommendations to improve these systems.

The CBE identified several areas of budgeting, financial management, and accounting that could be improved in order to provide greater efficiency and accountability. Recommendations and areas for improvement are described in detail in the following sections.

However, first we consider how LFUCG might best implement any suggested changes in order to achieve short-term efficiencies, financial savings, and more accountable and effective financial management and budgeting.

There are two approaches to changing LFUCG financial practices and budgeting – the easier way (incrementally) and the harder way (comprehensively). The easier way is to continue incremental or piecemeal applications of band-aids to each area of concern. A fragmented, or ad hoc, approach would likely be easier to implement in the short term since narrow or specific problems, several of which are known to policy-makers can be isolated and repaired, at least temporarily. The harder approach is to consider all the areas that could be improved as interrelated parts of a broader governmental system that requires major rethinking and reconstruction.

The incremental approach might achieve some immediate improvements, however, unless the changes become part of the broader governmental structure and operations, they are likely to be only stop-gap improvements and therefore unlikely to

achieve their full potential. Instead, we recommend that the LFUCG adopt a comprehensive approach to improving budgetary and financial structures and practices. We believe this strategic, comprehensive process should include the Council, the administration, and citizens. Strategic planning will help keep decision-makers focused on how specific policies or actions will help achieve desired goals, and will allow citizens as well as government officials to better assess whether stated goals are being achieved. A detailed analysis and roadmap of how to implement such a comprehensive approach is provided throughout the remainder of this report.

SECTION I. LFUCG STRATEGIC PLANNING

STEP #1: VISION STATEMENT

Defining a vision for an organization is the first step in thinking strategically and developing a strategic plan for that organization. Strategic planning is a systematic effort to produce decisions and actions that shape and guide what an organization is, what it does, and why it does it, but the focus of this planning process is the future. The strategic plan provides priorities and decisions about what an organization will do, why it will do it, and how it will do it. (Adapted from Bryson's - Strategic Planning in Public and Nonprofit Organizations)

There is no one-size-fits-all strategic planning process or one accepted model for a vision or mission statement for organizations or governments. In fact, the organizational process of thinking about and developing statements of vision and mission is often as important as the actual result of the process.

As one example of this visioning and strategic planning process, we include information from the city of Charlotte, North Carolina, which like Lexington, is one of the few merged city-county governments in the nation. In developing a strategic plan, the city of Charlotte asked “what do we want to be?”

The vision described for the city in the box below is the result of that strategic planning process and can be found in the report from Charlotte titled The State of the City: FY 2003. It can be found online at: <http://www.charmeck.nc.us/Departments/Budget+-+City/Performance+Measures/Home.htm>

Examples of vision statements:

<p style="text-align: center;">CITY OF CHARLOTTE – VISION STATEMENT</p> <p><i>The City of Charlotte will be a model of excellence that puts citizens first. Skilled, motivated employees will be known for providing quality and value in all areas of service. We will be a platform for vital economic activity that gives Charlotte a competitive edge in the marketplace. We will partner with citizens and businesses to make this a community of choice for living, working, and leisure activities.</i></p>

CITY OF MOBILE – VISION STATEMENT

<http://www.cityofmobile.org/html/plan/vision.php>

The elected and appointed officials of the City of Mobile, in partnership with our loyal merit system employees, will work diligently to continue to earn the ever-increasing trust, respect and support of our citizens as we strive to improve government operations and modernize our City's infrastructure.

STEP #2: MISSION STATEMENT

After a vision statement, the next step is to develop a mission statement for the organization. To identify and develop their mission, the city of Charlotte asked “why do we exist?” The mission statement for Charlotte also can be found in the 2003 Annual Report mentioned above.

Examples of mission statements:

CITY OF CHARLOTTE – MISSION STATEMENT

The mission of the City of Charlotte is to ensure the delivery of quality public services and to promote the safety, health, and quality of life of its citizens.
“Public Service Is Our Business”

CITY OF MOBILE – MISSION STATEMENT

We respect the dignity and worth of our citizens and value the diversity of culture, heritage and history within our community. We pledge to strive to improve the quality of life and opportunity for economic prosperity of all our residents by working to attract more visitors and industries and assuring all of our citizens a clean, safe, economically viable and progressive city that is responsive to changing needs.

Some organizations include with their mission or vision statements lists of core values such as citizen involvement, sustainability, collaboration and cooperation, equity, diversity, quality of life, or health and safety of the community. Again, these are only meant to be examples of how the LFUCG might begin to establish statements of vision and mission that will provide a foundation for strategic planning and goal-setting, and ultimately lead to a more effective and accountable budgeting and financial system. Initiating and continuing an effective strategic planning process will require commitment and cooperation from city leaders in the government and the community as well as meaningful citizen participation.

STEP #3: GOAL-SETTING

After developing vision and mission statements, the next step in the strategic planning process is the setting of goals that follow from the mission or vision. What must be done to accomplish the vision or mission of the organization? At this stage, since most vision or mission statements are somewhat broad or comprehensive, the goals that follow also will be somewhat broad. Comparing the strategic goals of Charlotte to Mobile suggests differences in the strategic planning process and differences in problems

and opportunities facing each city. Despite the differences, the two lists of goals reveal or make explicit the priorities of each city government.

Examples of goal-setting:

STRATEGIC PLANNING GOALS – CITY OF CHARLOTTE

- * *Maintain competitive tax rate*
- * *Reduce crime*
- * *Increase perception of safety*
- * *Strengthen neighborhoods*
- * *Provide safe, convenient transportation*
- * *Enhance service delivery*
- * *Promote economic opportunity*

STRATEGIC PLANNING GOALS – CITY OF MOBILE

- * *Provide essential services in the most efficient manner possible.*
- * *Maximize the effectiveness and responsiveness of public safety and public service programs.*
- * *Increase the quality of life for our citizens and visitors, both young and old.*
- * *Emphasize and facilitate economic and industrial development.*
- * *Continue to develop and improve our convention and tourism facilities and programs to increase our attraction as a destination city for visitors.*
- * *Develop short-term and long-term plans to improve our City's infrastructure (i.e., flooding, drainage, traffic flow, intermodal transportation, etc.).*
- * *Develop strong partnerships with community organizations, other governmental agencies, businesses and industry in our region.*

STEP #4: STRATEGIC PLAN

The above sections provide examples of the first steps in the strategic planning process for Charlotte, NC and Mobile, AL. The city of Tucson, AZ provides an example of a similar process that links strategic planning to the city budget and describes how a strategic plan can help improve the budgetary process. The description also is helpful in suggesting the time needed to develop the plan, some of the key steps in the process, and how the Tucson plan and its priorities will be evaluated.

TUCSON STRATEGIC PLAN

<http://www.ci.tucson.az.us/pdf/csp-intro.pdf>

*The City Strategic Plan sets forth a set of priorities for the city of Tucson and provides a framework for strategic planning, **which will help guide City resources and focus attention on results.** (emphasis added) On December 17, 2001, as part of the strategic planning process, the mayor and Council adopted six focus areas for the City for FY2003.*

- * Transportation
- * Neighborhoods
- * Downtown
- * Economic Development
- * Growth
- * Good Government

*During special strategic planning sessions held during January, February, March, and April, 2002, the mayor and Council discussed each of the focus areas in greater depth. **These working sessions were an important prelude to FY 2003 & 2004 budget preparations. In light of the difficult budget year ahead, having defined priorities for the City is of particular importance. This will enable City resources to be organized more effectively to accomplish Council priorities. Setting focus areas and identifying associated projects not only helps in directing limited resources in developing the FY 2003-04 budget, but also clarifies for staff the results that the Mayor and Council believe are important to achieve** (emphasis added).*

Within each focus area, the Mayor and the Council have adopted a set of strategies and priority projects. Taken collectively, the focus area projects set the workplan for the organization for the next fiscal year. Performance measures, which are included in this document, set specific indicators of progress for each focus area. City staff will report periodically to Mayor and Council on the performance measures and provide updates on the projects listed in this document.

CURRENT SITUATION: LFUCG MISSION AND GOAL SETTING

Although the LFUCG appears to have no government-wide strategic planning process in place, the webpage for the Chief Administrative Officer (CAO) <http://www.lfucg.com/CAO/> does provide a mission statement and five program goals with related objectives for that office.

As might be expected for the office of the CAO, the mission statement and goals focus on administration of resources and policies established by the political leadership of the city, but they also address more specific issues of fiscal management, personnel supervision, planning, infrastructure, and citizen participation in government. Several of the objectives are potentially measurable indicating that with effective data collection achievement of some goals and objectives can be evaluated and the organization can be held accountable for their work in these areas.

The webpage does not explain how this CAO mission statement and goal setting process was initiated and developed (who was involved, when was it completed, and how much time and what resources were needed), but the existence of this mission statement and program goals for the CAO does suggest that that a foundation exists in the LFUCG for developing a similar planning process for the entire government.

LFUCG CAO PROGRAM MISSION STATEMENT

To efficiently administer the community's local government resources and accomplish the directives and policies established by the Mayor and Council by providing administrative direction to departments and divisions, ensuring responsible fiscal management, meeting the community's public infrastructure needs, and assuring responsiveness to citizens.

LFUCG CAO PROGRAM GOALS

Goal 1: Provide direction for the LFUCG by implementing the administrative directives of the mayor and policies as established by the council.

Goal 2: Provide direction and supervision for departments and the Office of Administrative Services.

Goal 3: Ensure responsible fiscal management.

Goal 4: Provide for the maintenance, planning, and development of community infrastructure.

Goal 5: Ensure responsiveness of government to issues of citizen and community concerns.

Recommendations/Next Steps

The Mayor, Council, and CAO should implement a comprehensive LFUCG strategic planning process, as outlined below:

1) Create an LFUCG Vision Statement

- **The vision statement is meant to be long lasting**
- **Development of the vision statement should include input from all levels and departments of government and from citizens**
- **The vision statement may be revised from time to time, but it is not meant to be completely changed from one administration to the next**

2) Create Departmental Mission Statements

- **Each department should create a mission statement that supports the overall LFUCG vision**
- **Departmental mission statements are updated more frequently than the LFUCG vision statement, but these revisions are not necessarily tied to changing of the administration**

3) Create Goals & Objectives

a) Administration Level Goals

- **Presented by each new administration at the beginning of their term**
- **Must support vision & departmental mission statements**
- **Should describe a roadmap for the administration's priorities while in office**
- **Should lead to the development of quantitative goals at the department level**

b) Department Level Goals

- **Created by each department and revised annually**
- **Must support vision & departmental mission statements**
- **Must support the administration level goals**
- **Should be quantitative in some way (dates, dollar amounts, timelines, percentages, etc)**
- **Should describe a roadmap for the department’s ongoing priorities**

4) Create an LFUCG Budgeting Strategy

- **Should be based on the strategic planning outlined above**
- **Specific details and recommendations regarding the budgeting strategy are outlined in the following section**

SECTION II. LFUCG BUDGETING STRATEGY

A COMPREHENSIVE APPROACH TO LFUCG BUDGETING

The budget is the most important policy statement of any government. It reveals the organization’s values and priorities. Devising and implementing a successful, meaningful and accurate government budget strategy is a continual process of reconciling what citizens, taxpayers, and their elected leaders want and what they are willing to pay for.

Developing a successful budget strategy must be a continual process because the surrounding environment is not static. Economic, social, and other external variables that affect both the revenue and expense sides of a budget are always changing. As a result, the budget strategy should not be a static, one time per year event. However, it appears that the LFUCG budgeting process is mostly concentrated into a static, one time per year event with little or no long term budgeting strategy taking place.

STRATEGIC BUDGETING AND THE ANNUAL BUDGET DOCUMENT

The LFUCG has received the Government Finance Officers Association “Distinguished Budget Presentation Award” for several years in a row, and should be commended for this recognition. This national award indicates that the “Annual Budget” document was reviewed by a panel of budget experts and met certain established nationwide criteria as a policy document, operations guide, financial plan, and a communication device. However there are two areas where we believe some improvement is needed – strategic budgeting/planning and performance budgeting.

First, the budget process lacks a strategic focus. Since the LFUCG lacks a strategic planning process, this weakness in the budgeting process is understandable. However without “top-down” guidance on mission, goals, and objectives, the budget process tends to be somewhat fragmented and uneven. Although revenues and spending are forecast five years into the future in an “Annual Budget” document that LFUCG submits for an annual award, these forecasts do not relate to any overall plan or set of strategic goals and objectives that are followed by policy-makers.

For example, some decision makers we interviewed were not aware of the “Annual Budget” document or the fact that it contained five year revenue and spending forecasts. Rather, the one year “Mayor’s Proposed Budget” and the “Council Budget” with no projections beyond the current fiscal year are the budget documents that strategic decision makers are most familiar with and refer to when discussing the annual budget. Additionally, we question the degree to which the five year revenue and spending forecasts contained in the “Annual Budget” document, are actively reviewed or analyzed by administration or council strategic decision makers in creating the following year’s “Mayor’s Proposed Budget” and the “Council Budget.”

BUDGET STRUCTURE

The structure of the current budget also impedes meaningful long or short term strategic planning or analysis. This is demonstrated by the fact that the annual budget is not broken down into monthly, or even quarterly, periods. Rather, it is shown as one lump sum annual budget.

This process makes it difficult to analyze the rationale behind revenue and expense forecasting and to produce accurate and reliable year-to-date reports. The lack of monthly period data makes it necessary for one to assume that revenues and spending are equally spread across all twelve monthly periods when receiving a report that states “62% of spending category B has been spent, and we are 56% of the way through the fiscal year”.

The lack of monthly period data also reduces the quality of monthly or quarterly reporting throughout the year, as the annual budget does not have similar periods to use for comparison to actual spending. This makes effective decision making nearly impossible, and leads to the possibility of being ‘blindsided’ by large shortfalls or surpluses in any specific area, or in the overall budget itself.

SURPLUSES

Another important component of government budgeting is managing surpluses. Governments as well as businesses need to have some cash set aside for emergencies and other unforeseen circumstances. We have not found sufficient emphasis or focus within the annual budget on the Economic Contingency Designation, often referred to as the ‘rainy day fund’.

Although a policy does exist regarding the appropriate balance and uses of this fund, there does not seem to be an overall strategy in place for this fund. As one example, there is not even visibility of the ‘rainy day’ fund’s current balance in the current budgeting or reporting processes, other than the aforementioned “Annual Budget” document, which is produced after the “Council Budget” has already been created, approved and formally adopted. Rather than outlining a strategic plan for the best uses of the ‘rainy day fund’, LFUCG decision makers simply referred us to the fact that “Ordinance 243-96, Section 2 details what this fund can be used for.” This serves as an example of how a non-strategic mindset can become an obstacle to long-term planning in an organization.

The Operating and Capital Budget Request Manual contains a form to request “New or Expanded Services.” This form takes division managers through a process of estimating the financial impact of any new or expanded services, however it is not clear how estimated savings from these implementations are incorporated into the actual budget. Most of the operating expenses are budgeted based on spending for the prior year, so if these benefits are not budgeted in the year that the project is undertaken, there is a good chance that these benefits may be lost. We recommend that a connection between these new or expanded services and the budget be made more direct and visible to ensure that all savings are realized and accounted for.

CAPITAL BUDGETING

Capital planning is a crucial part of the budgeting process. As part of the budget process, department managers are asked to present in detail their capital needs, however there is some confusion as to whether this capital detail includes equipment, or includes only construction projects. We believe the capital planning process should include equipment needs. Also, the Operating Capital Request Form asks department managers to outline projected capital needs if they exceed \$100,000 for the next 5 years. We recommend that this threshold be lowered to \$50,000.

The ability to anticipate the need for large expense items is fundamental to the long term planning process, and anticipating these needs is a key element in planning for the use of monies from bond issues. We recommend that funds generated from the borrowing capacity of the government be used to purchase projects with an expected life equal to the life of the debt. Borrowing long term to purchase assets with an expected useful life of five years or less will simply mortgage the future of Lexington and should be avoided. We recommend that long term debt be issued primarily to meet the needs of construction or land development projects.

PERFORMANCE BUDGETING

Another example of fragmentation and lack of cohesion in the budget process is in performance measures. A performance budget provides data on services and programs being provided and how much work is being done at what cost. Performance budgeting attempts to shift attention from detailed line-items of expense such as salaries and travel to the allocation of resources based on a strategic plan with program goals and measured results. Measuring results helps clarify the broad goals and concepts of the strategic planning and strategic budgeting processes (assuming those are available and used).

As mentioned previously, performance measures appear in the Annual Budget document but do not appear in the Mayor’s Proposed Budget or the adopted Council Budget. It would seem that if these measures were a key component in the budgeting process they would appear in all versions of the budget document so they could be reviewed and evaluated at all stages in the process.

Although all LFUCG departments have developed at least some rudimentary performance measures, some departments are much more advanced with more informative and useful measures than others. Given the complex task of designing

performance measures for government agencies with very different types of missions and programs that usually lack a “bottom-line,” this weakness is to be expected. A LFUCG strategic plan would provide a consistent framework for a budget strategy and facilitate the development of more consistent and cohesive measures of agency performance.

The performance component of the budget needs more consistent application of measures of: (1) demand or potential workload; (2) actual workload or work completed; (3) efficiency/cost; and (4) effectiveness/outcomes. The performance budgeting component of the budget also lacks reference to or use of benchmark data to compare department or program performance to similar agencies in other local governments.

ANNUAL PLANNING PROCESS

In addition to the weaknesses of a static, one year budget process, determining the inputs for this twelve month budget appears to be a fragmented and disjointed process. Budget preparation is condensed into a several month period, and consists of two somewhat separate and unrelated paths. The administration first develops a draft budget with little input from the Council, and then the Council offers a counterproposal later in the process.

This approach creates a situation where the legislative body must react to the administration’s proposals, rather than having the opportunity to proactively participate in the development of the budget. The result is a process of political bargaining and trade-offs limited by severe time constraints instead of a more comprehensive, strategic exercise in resource allocation. We understand that the LFUCG budget is ultimately a political document with many groups, interests and policy-makers contending over the allocation of these resources, however there is much room to improve planning, analysis, and communication in the process.

A budgetary process that is accountable, comprehensive, and effective is crucial to achieving more accountable and effective government. We feel that the current lack of overall budgeting strategy prohibits LFUCG from maximizing its full potential as an accountable and effective government. Detailed recommendations for improving this current process appear below.

Recommendations/Next Steps

1) LFUCG Should Create a 3 Year Planning Budget

- **Planning for this 3 year budget is done by a budget planning team consisting of the Mayor, CAO, Budget Director, commissioners, three council members, and three private sector/citizen representatives**
- **The budget planning team should meet quarterly to update the planning budget**
- **Meetings designed for meaningful public input should be held at some point during each of these quarterly planning sessions**
- **This three year planning budget is ‘approved’ by the planning team; however, it is not officially “adopted, ratified or approved” by the full council in the manner of the Mayor’s Proposed Budget**

- 2) Council members should be involved in all stages of the strategic budgeting process**
 - Council members would now be included from the beginning of the process, due to the presence of three Council members on the budget planning team, which meets for quarterly planning sessions on the three year planning budget
- 3) The annual budget should flow from the three year planning budget**
 - Since all key stakeholders are included in the planning budget, fewer changes/updates should be needed to create an annual operating budget
- 4) The annual budget for the general fund should include monthly period data once a new IT system is in place**
 - This allows budgeting and finance personnel to provide decision makers with more detailed and meaningful reports regarding “budgeted vs. actual spending”
 - This enables decision makers to make more informed and accurate decisions
- 5) The Economic Contingency Designation, or ‘rainy day fund’, should be more visible and be included in the strategic budgeting process**
 - An accounting of funds to be transferred to the ‘rainy day fund’ balance should be shown for each period in all budget documents.
 - Although a policy exists regarding an appropriate balance for the ‘rainy day fund’, this policy should be followed, and the policy should be revisited periodically
 - A policy should be created that describes how quickly the ‘rainy day fund’ balance needs to be replenished to its minimum balance in instances where it has fallen below that minimum
- 6) The ‘Capital Improvement Plan’ should be more visible and should be included in the strategic budgeting process**
 - The 20 year capital needs outlook initiated in 2003 is a positive addition to the previously existing six year Capital Improvement Plan
 - The plan needs greater visibility and the strategic inputs to this plan need to be clarified and publicized
- 7) The LFUCG performance budget component should be based on a strategic plan for the entire government as well as a strategic plan for the budget**
 - The budget should not be based on some consistency in performance measures across programs and departments
 - The budget should include benchmarking data
- 8) Ongoing training is needed for all persons serving on the budget planning team**

SECTION III.
LFUCG FINANCIAL REPORTING AND ACCOUNTING SYSTEMS

Current LFUCG accounting systems are a hindrance to effective financial management. Existing computer systems for finance and accounting require manual intervention and lack integration between departments needed to be an effective tool in delivering appropriate financial information to decision makers and to the public. While Finance Department personnel are to be commended for their attempts to produce accurate and timely financial statements, they often must allocate more time and resources to dealing with technical issues than to analyzing and presenting financial information.

Investment in new financial systems would result in significant operational efficiencies which would allow for fewer clerical staff to be involved in the inputting of financial data. These data-entry persons could be replaced with fewer, more highly trained financial professionals who could bridge the information gap that often appears to occur between the financial personnel in the administration and the Council.

MONTHLY FINANCIAL STATEMENTS

It usually takes from 20 to 30 days to produce monthly financial statements. Accurate and up-to-date financial information is imperative for effective decision making, and the need to improve this process is evident in all LFUCG financial reporting, but is especially evident in the budgeting process.

Currently department managers receive their budget request forms in December and are expected to complete them by the end of January. Although some of the larger divisions will not return their budget requests until February or March, divisions that return their projections in January are working with only three to four months of actual results from the current year before they are expected to project the next fiscal year. Given existing LFUCG computer systems it is understandable why this timetable has been imposed, but the need to start projections this soon in the process adds to the difficulty of the task, and makes the likelihood of accurate projections less likely.

We recommend that the timetable for the budget process be condensed to start in January with projections due from the divisions in early March. This recommendation can easily be achieved after implementation of new financial processing software and implementation of the 3 year planning budget.

The LFUCG budget is prepared on an annual basis, however many of the expense and revenue streams are time sensitive. For example, residential property taxes are collected primarily between October and December. Many expenses, such as the audit of the financial statements will not occur until the end of the year. To meet these and other needs, the budget should contain monthly period data with costs and revenues projected in the months they will be recognized. This should help to make projections more accurate, and will definitely assist the reader of the financial statements.

With a budget containing both monthly and a year to date variance, the reader of the financial statement can easily determine the specific categories where the budget is likely to be attained or where there is a potential shortfall. With a Council made up of hard working, part time members, it is imperative that financial reporting be as easy to understand as possible. This also is important for increasing citizen participation in the budgeting process. This change should be implemented as soon as possible.

Once a budget with monthly period data is operational, the budget process will become more effective as better historical financial data are available to division managers and other administrators. The monthly format also will provide a mechanism for tighter control of budget variances. We also recommend that division managers be asked to present a budget variance report to the Mayor on a quarterly basis. These budget variance reports should be reviewed by the Budget Planning Team during their quarterly meetings as outlined in the Section II recommendations above.

INTERNAL AUDIT STAFF

Our review found that the Internal Audit Staff of the Lexington Fayette County Government includes only two people. In order for this staff function to be effective and provide the assurance of effective monitoring of spending, we recommend that this staff level be increased. We suggest that a brief study of how other cities staff this type of department would provide an appropriate benchmark for the optimal staffing level.

EXPENSE CATEGORIES

We recommend that division budgets be adopted with three expense categories: personnel, capital and operating expenses. If funds need to be moved in a particular division's budget between line items of their operating budget, we propose that the division manager be allowed to make these decisions, as long as their total for operating expenses will come in under or on budget. If a division manager needs to move money between the three primary categories, the proposed change should be presented to the Council. Additionally, we propose that all line item reclassifications that exceed \$10,000 or 5% of a unit's operating budget should be summarized and presented to the Council for their review. Action would not be required from the Council to approve the reclassification, but the Council could reject any proposed reclassification.

BUDGET AMENDMENTS

The budget amendment process was a concern of many of the people interviewed. The number of budget amendments, and the time and information required to review and evaluate them in Council meetings appear to make the budget amendment process less than effective.

Our assessment shows that the current line items used in the budget and policies regarding line item variances constrain both the administration and the Council. Current practice requires a budget amendment every time a line item has a variance to its budgeted amount. We feel that this bogs down the system with unnecessary paperwork, and once again shifts the focus from a high level, long term strategic outlook, to a more limited, short-term outlook.

Once capital projects are undertaken, cost overruns are often presented to the council after the work has been completed. To simplify this process while still maintaining accountability, we propose that managers of capital projects be required to obtain approval before change orders are processed. If the cumulative total of the change orders is less than 5 percent of project costs and if less than \$10,000, the change request can be approved by the CAO and presented to the Council at the next meeting. However, if the total of the change orders exceeds 5 percent of project costs or if more than \$10,000, the change request must be approved in advance by the Council. If approval of a variance is time sensitive, the Budget Committee of the Council should be authorized to approve the variance.

USER-FRIENDLY FINANCIAL REPORTS

The emphasis of the financial reporting should be on the information that the end user needs. The current financial reporting system limits the financial staff in the quality of the information they can provide to Council Members. Often detailed information is presented in screen print form, rather than being available in an easier-to-read summary. Once a new accounting system is purchased and implemented, as officials design the many components of financial reporting there should be a new emphasis upon the reader of the new financial statements. “User friendly” reports should be developed. Narratives summarizing significant financial events should accompany financial statements and budgets.

Recommendations/Next Steps

The LFUCG should move quickly to:

- **Adopt division budgets with three expense categories: personnel, capital and operating expenses**
- **Create strategic guidelines for the three newly adopted expense categories. These guidelines should be based on benchmarking data gathered from other cities**
- **Budget amendments should no longer be required for simple line item variances; rather, they should only be required if there is a variance in one of these three larger expense categories**
- **Increase the internal audit staff**
- **Develop user-friendly financial reports with monthly period data**
- **Improve the capital budgeting process**

SECTION IV. LFUCG INFORMATION TECHNOLOGY

The ability to implement the many budget and finance recommendations proposed in this report will be severely limited due to inadequate information technology (IT) systems in the LFUCG. Whether in the for-profit, non-profit, or government sectors, information technology has become a crucial element of successful organization activity. As modern organizations become ever more dependent on data for decision-making, IT often determines the success or failure of an organization’s mission and goal-achievement. Communication, information-sharing, timely decision-making, planning,

accountability, and evaluation of policies and programs, especially in budgeting and finance, are crucial to government effectiveness and all these functions require effective information technology.

Although there are some examples of effective implementation of IT, the LFUCG appears to be many years behind comparable city governments in the adoption of functional and integrated IT systems, and even further behind much of the private sector. LFUCG currently maintains many separate, non-linked IT programs that are costly to maintain and dependent on the experience of just a few senior employees who have been involved in these disparate systems over many decades. Apparently three programmers maintain hundreds of separate programs and several of these employees may be retiring soon taking with them their years of experience and knowledge of these in-house programs.

Getting timely and accurate data to manage the diverse and complex programs and functions of the LFUCG has become increasingly difficult and costly. Some officials apparently recognize this deficiency and this year's budget provides funding for an assessment of IT needs, and an RFP for consulting on this issue has been developed. We believe IT is a critical need and this assessment should be fully supported by LFUCG policy-makers

The LFUCG should pursue the acquisition and implementation of an Enterprise Resource Planning (ERP) tool. An ERP software package can link all departments and functions of an organization into a single system that can serve all departments' needs. It can streamline and integrate all governmental processes and provide a structured approach to optimizing LFUCG's operations through visibility and common data across all sectors of the government.

LFUCG's operations require IT effectiveness in three areas: Government-to-Citizen (G2C), Government to Business (G2B), and Government to Government (G2G). An ERP can facilitate all these components in one platform. An ERP not only can provide the IT system infrastructure foundation upon which to build and manage future tasks and functions, it can be a catalyst to develop best in class processes, manage costs, eliminate redundant work, improve service efficiency, and facilitate web-based transactions. An ERP would provide data for LFUCG administrators and policy makers to make timely and information-based decisions and provide the means to implement more effective budgeting and financial systems.

Implementing an ERP would facilitate improvements in three key areas:

- 1) Reductions in Costs
- 2) Improvements in Efficiency
- 3) Improvements in Decision Making

Some examples of potential areas of improvement an ERP can provide include:

Increased citizen satisfaction resulting from improved web-based capabilities:

An ERP would facilitate the ability to conduct “e-government” via web-based submission of forms, applications, payments, etc. Many best-in-class governments are providing web-based transactions for their constituents thereby adding value to the citizen and reducing costs for the government.

- Charlotte-Mecklenburg offers a wide range of online or “eServices” including payment of taxes, water bills, and parking citations as well as a form to request “street humps” or “traffic calming requests.”
- San Diego offers many services including paying taxes, applying for a government job, and renewing a library book. The site also allows a citizen to enter in his or her address and access all government services that are applicable to that neighborhood.

Data visibility is greatly enhanced:

Data would now be available in an electronic “data warehouse” where information can be searched, filtered, and sorted as desired by the user reducing the need for labor specialization in report creation.

Common data are now easily accessible across departments:

Instead of different departments using their own data, with an ERP all departments build from the same information. Ease of access facilitates improved day-to-day management. In addition, these same data can be made available to citizens via the web.

Financial processes are greatly enhanced due to the capability to move and monitor transactions electronically:

The elimination of paper transactions dramatically reduces errors and labor costs. Accurate and timely information leads to reduced reconciliations and better management of the billing process leading to quicker payment and a reduction in accounts receivable, number of disputes per transaction, cycle times for the transaction, and lower write-offs. One also typically sees improvements in the time to process accounts payable invoices and reductions in re-work from improved invoice accuracy. Reduction in the amount of term discounts lost (as a % of total purchases) is achieved. Improvements in time required to close the books is usually between 35% and 80%. Report generation is dramatically improved. Given LFUCG’s highly manual process, this change should provide significant time and labor savings.

Procurement and inventory cost reductions:

Due to e-procurement capabilities, supply costs typically are reduced as well as the time usually required to receive goods. Visibility and process improvement facilitates the leveraging of preferred vendors and reduces “maverick” purchasing.

Data accuracy is improved:

Organizations typically see a dramatic improvement in data accuracy. Data are input into one system instead of many, thereby reducing errors. The benefits of improved data accuracy are broad and substantial, including improvements in citizen satisfaction, reduction of re-work costs, and improved decision making.

Reporting is improved:

Reporting is not only greatly enhanced but also becomes more timely and cheaper to produce as automation replaces manual reporting. Data auditability is improved with reduced costs for ensuring data integrity and no need for reconciliation between multiple IT systems.

Monitoring organization performance is much easier:

The ability to monitor actual performance compared to goals, plans, and budgets moves from delayed reaction to real time. The organization can react quicker and with greater knowledge of issues. Decision making is transformed from post-problem analysis to more pro-active data-based decision making.

An ERP would provide data for LFUCG administrators and policy makers to make more timely and information-based decisions and provide the means to implement more effective budgeting and financial systems. It would facilitate the movement from an organization that is more departmentally-based to an organization that is more integrated with a process-based mode of operation that is cross-functional, disciplined, and consistent.

Examples of leading ERP providers are SAP, Oracle, JD Edwards, and PeopleSoft. The University of Kentucky is using SAP as its software vendor in their ERP project which is called IRIS (<http://www.uky.edu/IRIS/>) The LFUCG should investigate this adoption of ERP as a possible resource when a decision is made to move to this type of system. Various UK staff would likely have much experience and expertise to share with LFUCG. Other local institutions and businesses also might have experiences with ERP adoptions to share with the LFUCG.

Recommendations/Next Steps

Existing IT systems limit LFUCG's ability to effectively manage its budgeting and financial processes and impede the ability to control costs, increase efficiencies, and make informed decisions. The LFUCG should:

- 1) Reaffirm the commitment to the planned IT needs assessment and move this project forward with the highest sense of urgency.**
- 2) Ensure a cost-benefit analysis of an ERP system is included as part of the overall IT assessment. Although the cost to purchase and implement these systems can be substantial, the benefits usually exceed costs.**
- 3) Act quickly on the recommendations of the IT needs assessment.**
- 4) Seek input from other governmental entities that have adopted an ERP to understand implications, benefits, and potential benchmarks.**

5) Seek input from several local institutions that have also moved in this direction that could provide insight such as the University of Kentucky, Ashland, Inc., and others.

SUMMARY AND CONCLUSIONS

We believe LFUCG employees generally are doing the best they can to implement and administer a complex mix of programs and services under significant limitations and deficiencies in planning, budgeting, and IT systems and processes. Our analysis and proposals for improvement focus on weaknesses in structures, systems, and processes that have developed over many years and many different administrations and Councils. We believe that confronting these problems quickly and comprehensively offers opportunities for substantial improvements in the functioning of the government.

To summarize, we find that the LFUCG lacks a strategic planning process; budgeting and financial reporting is fragmented and non-strategic; the current budget process does not have a comprehensive, integrated focus on performance or results; and the IT system is outdated and ineffective.

To address these deficiencies, we recommend that the LFUCG implement a strategic planning process including vision statement, department mission statements, goals and objectives, and a budget strategy; initiate a 3-year planning budget; redesign financial reporting system with end-user in mind; and upgrade or replace the existing ineffective IT system and implement a government-wide Enterprise Resource Planning system. An ERP is a substantial investment, however we believe it is essential to accomplish the goals and recommendations outlined in this report

Although some of the recommendations in this report can be accomplished relatively quickly and with minimal investment of resources, others will require much more time, effort, resources, and determined leadership to be adopted and implemented effectively. These proposed changes offer a significant challenge to city leaders, but one that must be addressed if Lexington is to have a government that is effective and efficient in finance and budgeting, and accountable to its citizens.