A 12-STEP PROCESS TO FINANCIAL RECOVERY

A Guide to the GFOA’s New Online Resource

BY SHAYNE C. KAVANAGH
Financial recovery is the process of recognizing, arresting, and reversing a pattern of financial decline. However, recovery is not just about stopping decline. The ultimate goal of financial recovery is to use the experience of the recovery process to make the organization more resilient than it was before the distress occurred. The Government Finance Officers Association (GFOA) has developed a 12-step process (divided into three stages) for recovering from financial distress. Exhibit 1 shows the 12-step process graphically.

The GFOA has developed a comprehensive online resource that describes the recovery process in detail, which you can visit at www.gfoa.org/financialrecovery. This article gives an overview of the recovery process and highlights some of the additional information about recovery that is available on the Web site.

OVERVIEW OF THE RECOVERY PROCESS

The recovery process has three broad stages — bridging, reform, and transformation. The objective of the bridging stage is to get through the immediate crisis and create breathing room for making more sustainable reform. During the bridging stage, members of the organization who would lead the recovery

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**Exhibit 1: GFOA’s Process for Recovering from Financial Distress**

<table>
<thead>
<tr>
<th>Stages of Financial Recovery</th>
<th>Stages of Financial Condition</th>
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<td>Bridging</td>
<td>Decline</td>
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<td>Reform</td>
<td>Distress</td>
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<td>Transform</td>
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<td>Recovery</td>
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<td>Financial Health</td>
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The first step in recovery is recognizing that a real problem exists.

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Note: The GFOA’s 12-Step Diagram was inspired by work from Corporate Renewal Solutions (http://www.corporate-renewal.co.za/).
must recognize that financial distress exists and convince a critical mass of stakeholders that this is the case. The participants must then diagnose the causes of distress and apply fiscal first aid (i.e., retrenchment) tactics to stabilize the situation. The final step of the bridging stage is to develop a recovery plan.

In the reform stage, the organization carries out the short-term recovery plan and develops and implements long-term treatments for financial distress. A critical part of the reform stage is to start a formal long-term financial planning process.

The final stage is transformation. A hallmark of this stage is institutionalizing long-term financial planning and becoming more resistant to financial distress and adaptable to a changing environment.

THE 12 STEPS

The 12 steps of the recovery process, outlined below, are part of these three stages. There is also a thirteenth step — when a recovery process fails.

1. Recognition

The first step in recovery is recognizing that a real problem exists. Someone in a position of authority must first recognize the problem and gain a substantive understanding of it — what revenues look like for the next six to 12 months, where major expenditure pressures are coming from, and the magnitude and nature of the total problem. For example, to what extent is the problem structural versus cyclical? Will an economic recovery solve the problem or just lessen it?

The leader of the recovery process must also recruit supporters into the recovery process. This can be done by: crafting a message to help others recognize the magnitude and duration of the problem; demonstrating a convincing understanding of the situation to inspire confidence; and preparing immediate fiscal first aid tactics for near-term relief and to stave off panic.

2. Mobilization

Once a critical mass of people inside the organization has recognized the need for a recovery process, it is time to mobilize for the recovery. Successful recovery is the product of a team effort. As such, a team structure is essential to the recovery process, and a strong core team is at the heart of a successful recovery. The team defines a vision of what financial recovery looks like and enlists others in supporting that vision. Team members also evaluate potential strategies for recovery and mobilize others to assist in the recovery — for example, other staff members might be recruited onto subteams to analyze important issues and recommend strategies. The recovery Web site provides additional information about forming teams and analyzing stakeholder groups to understand how they might help or hinder recovery.

3. Generic Treatments

Retrenchment techniques might be needed right away, when there is not time for much preceding analysis. Techniques that work in this situation produce a yield in a very short period of time, have clear short-term benefits and long-term ramifications, are easy to explain to others, and can be undone with a reasonable amount of effort. Examples of these types of techniques are presented below, and additional examples are available on the site.
1. **Fiscal Position and Parameters.** This part of the fiscal health model covers cash position, reserves, revenues, and expenditures.

2. **Budget Practices.** The budget ultimately creates or destroys fiscal balance.

3. **Liabilities.** Liabilities represent potentially very large obligations or unsustainable practices that could seriously harm financial condition.

4. **Political and Economic Environment.** The political and economic environment is the foundation of fiscal health.

- **Reassess Personnel Equipment Needs.** Personnel might have been assigned equipment that isn't completely essential to the job, and the government might now be willing to live with the lower level of service associated with eliminating that equipment. Examples might include cell phones, personal digital assistants, uniforms, individual desktop printers, and take-home vehicles.

- **Short-Term Hiring Freeze.** A short-term hiring freeze that lasts a few months or simply extends the time a position is vacant might provide some immediate financial relief.

- **Allow Voluntary Part-Time Status.** Letting employees volunteer to move to part-time status is a relatively non-controversial way to save money on salary costs (and fringe benefits that are based on salary).

**4. Initial Diagnosis**

The diagnosis identifies the causes of financial distress. Knowing the causes will help the recovery leaders select the most appropriate fiscal first aid techniques. An initial diagnosis focuses on the immediate causes of financial distress. Throughout the diagnosis, the recovery leadership should look for the problems that have the most recovery leverage. These are problems that:

- Can be solved or mitigated through a reasonable investment
- Offer a significant return on that investment
- Will provide a return soon enough to help stabilize situation quickly.

Involving others in conducting the diagnosis brings additional perspectives into the process. Employees often have good ideas about where the problems lie and how to deal with them. Involvement can also relieve the unease associated with the recovery process. It removes some of the mystery around the process and promotes the sense of doing something about the situation.
The diagnosis will be better if it is guided by an explicit diagnostic model. A good model guides the diagnosis and, often, uses a metaphor to convey meaning and focuses on the fundamentals. Exhibit 2 provides an overview of a model. More detail and specific diagnostic questions are available at gfoa.org/financialrecovery, along with advice on how to conduct a diagnosis.

5. Fiscal First Aid

When afflicted with financial distress, a jurisdiction first needs to stabilize the situation. Fiscal first aid techniques can be used to stop the bleeding and provide immediate relief. Cases of more severe distress might not be completely resolved by fiscal first aid, but it can provide a short-term respite and time to develop more permanent treatments. In less severe cases of financial distress, fiscal first aid alone may be sufficient. The GFOA recognizes four categories of fiscal first aid tactics:

- **Primary Treatments** are the first line of defense. In many cases, these treatments provide immediate help and improve the long-term prognosis. Examples include improving billing and collections and improving capital project management to reduce cost and schedule over-runs.

- **Treatments to Use with Caution** may be called for if the primary techniques are not sufficient. However, these treatments could potentially worsen the financial condition if they aren’t used properly. Examples include deferring capital mainte-

Understanding the root causes of financial distress is essential to a lasting recovery.

- **Treatments to Use with Extreme Caution** might help the near-term financial situation but could work against financial sustainability. Examples include deferring employee compensation (e.g., higher future pension benefits) or a general tax increase.

- **Treatments Not Advised** are ones that can get you in trouble, such as accounting manipulations or failing to fund long-term liabilities.

The GFOA recovery Web site provides a comprehensive catalogue of first aid techniques.

6. Detailed Diagnosis

Understanding the root causes of financial distress is essential to a lasting recovery. Just as you diagnose the immediate causes of financial distress to select the best fiscal first aid techniques, you should also diagnose root causes, preferably using a structured framework. Noted public finance scholar Charles H. Levine designed a four dimensional framework of potential causes of distress, shown in Exhibit 3.

Descriptions of specific causes of distress within these four categories, including symptoms to look for, are available at gfoa.org/financialrecovery.

7. Recovery Plan

The recovery plan sets forth the strategies that will be used to achieve financial recovery. It helps the recovery lead-
ership crystallize, focus, and summarize strategic direction and key turnaround strategies and tactics. The process of developing a plan also allows the organization to begin and/or practice the cultural and behavioral changes needed to reach financial sustainability. Before staff can develop the plan, they must analyze goals, priorities, and services, and do so while thinking strategically about finances and working as a team. A documented plan also gives stakeholders greater confidence in the recovery process. Visit the recovery Web site to see key features of a recovery plan.

8. Long-Term Treatments

Long-term treatments are intended to effect fundamental change in the government and make lasting improvements to its financial position. Below are major categories of long-term treatments:

- Enhance Planning
- Improve Efficiency
- Reform the Budget Process
- Support Economic Development
- Address Long-Term Liabilities
- Metropolitan Area Restructuring
- Contain Personnel Costs
- Improve Community Attachment
- Improve Leadership and Management
- Become More Innovative
- Increase Accountability
- Address Legal Constraints

The recovery Web site provides explanations of the most important treatments in each category.

Take a portfolio approach when selecting your long-term treatments. A balanced portfolio will address root causes of distress from across the categories shown in Levine’s framework. The recovery Web site categorizes treatments along the framework, as well as by topical area.

9. Long-Term Financial Planning

A long-term financial plan is a combination of technical analysis and strategizing where long-term forecasts and analysis are used to identify long-term imbalances. Then, financial strategies are developed to counteract these imbalances. A plan develops big-picture and long-term thinking among elected and appointed officials. A financial plan supports recovery by maintaining a focus on long-term financial condition and issues. This helps the organization to act before a long-term imbalance becomes an immediate crisis. A plan also builds the case for action by making stakeholders aware of long-term issues and increasing their desire to confront them. The recovery Web site describes the steps of long-term financial planning in more detail.

10. Recovery Leadership

Leadership is critical to a financial recovery and, as the diagram of the recovery process shows, leadership is necessary at all stages of the recovery process. A leader articulates a vision of what will be achieved through financial recovery. In addition, a leader demonstrates and embodies the behaviors and attitudes necessary for regaining financial health. He or she engages stakeholders in the recovery process and enables them to make meaningful contributions. A leader makes tough decisions and keeps the recovery process on track and moving forward. The recovery Web site contains much more information about who fills the role of leader, traits of effective recovery leadership, how the recovery leader can work with elected officials, and the tasks that are required of the leader in different stages of recovery.

11. Manage the Recovery Process

Leadership is required in a financial recovery in order to
make the major changes in organizational performance necessary to pull out of decline. Good management is needed to keep the recovery process on track. The “recovery manager” must develop a recovery plan, manage project and government-wide budgets, organize people, monitor progress, and hold people accountable for results. The recovery Web site covers specific management tasks for the recovery project. It also provides an overview of general project management concepts, which will be useful during many steps of the recovery process. Topics on the site include crisis management, implementing plans, and managing the budget process.

12. The Outcome of Recovery

The goal of the recovery process is institutionalizing long-term financial planning and becoming more adaptable to changing conditions, more resistant to financial distress, and more able to regenerate in the face of setbacks. This condition is known as “financial resiliency.”

A financially resilient government has recovered its financial stability and gone on to implement strategies, control mechanisms, budgeting techniques, and early warning systems to make sure it can withstand future financial shocks. There are eight characteristics of a financially resilient government, which are further described on the recovery Web site. Those characteristics include:

■ **Diversity.** Avoid a single point of failure or reliance on a single solution. Keep a multi-faceted perspective on financial health. Consider more than revenues and expenditures. Keep in mind land uses, demographics, long-term liabilities, and other factors impacting financial position. Also, enlarge the base of supportive constituents and engage them beyond your core constituency so the local government has allies in times of distress. Allies can support taxes, vote in elections, and volunteer to help.

■ **Decentralization.** Centralized systems look strong, but when they fail, the failure is catastrophic. Make managers actively manage their cost and revenue structures so that budget control does not depend on centralized monitoring. Also, engage departments in identifying financial issues, analyzing them, and developing strategies. This creates strategic financial thinking in the departments.

■ **Transparency.** Don’t hide your systems. Transparency makes it easier to figure out where a problem may lie. Share your plans and preparations, and listen when people point out flaws. Promote transparency in areas such as goals and objectives, forecast assumptions, and reserve standards. Transparency leads to trust in the system. People are more likely to support and follow a system they trust. Use full-cost (direct and indirect) accounting for programs, which makes the cost of doing business transparent and leads to better decisions on resource allocation.

13. When Recovery Fails

The recovery process doesn’t always go as planned. When a local government slips deeper into fiscal distress, it might have to contemplate more dramatic options. More common is state intervention in the business of distressed municipality. Much less common is municipal bankruptcy, which the GFOA strongly recommends that governments take every possible step to avoid. The recovery Web site provides more details on the considerations behind municipal bankruptcy.

**CONCLUSIONS**

Recovery from financial distress is a journey that requires leadership, skill, and hard choices. However, the recovery process does not just address dollars and cents — it is really about creating better value with public funds so taxpayers get the most for their money. When recovery addresses creating more effective and efficient government, it will attract a larger and more committed group of supporters. The GFOA’s 12-step recovery process is intended to help public officials affect this kind of more complete recovery.

**Note**


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