

BY SHAYNE C. KAVANAGH

The concept of sustainability has captured the attention of local government leaders across the United States and Canada over the past few years. This includes finance officers, as the term “financial sustainability” has come to signify practices such as directing one-time revenues away from recurring expenses and taking into account long-term maintenance and operating costs when planning and evaluating capital projects.

However, the current recession has taught us that sustainability is a necessary but insufficient condition to ensure the ongoing financial health of local government. A sustainable system is balanced, but an external shock (such as a severe economic downturn) can unbalance the system and perhaps even cause its collapse. Local governments will continue to be faced with serious challenges from the outside, including but not limited to economic adjustments, natural disasters, and important policy changes by other levels of government. As such, finance officers must strive to help their organizations go beyond sustainability to a system that is adaptable and regenerative — in a word, resilient.

**A sustainable system is balanced but potentially brittle. A resilient system not only survives shocks, it thrives.**

Jamais Cascio, a fellow at the Institute for Ethics and Emerging Technologies, identifies eight essential characteristics of a resilient system:<sup>1</sup>

- **Diversity:** Avoid a single point of failure or reliance on a single solution.
- **Redundancy:** Have more than one path of escape.
- **Decentralization:** Centralized systems look strong, but when they fail, the failure is catastrophic.
- **Transparency:** Do not 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.
- **Collaboration:** Work together to become stronger.
- **Fail gracefully:** Failure happens. Make sure a failure state will not make things worse.

Decentralization is about engaging operating departments in financial planning so all departments think more strategically about finance. Long-term financial health does not rely solely on the efforts of central administration.

- **Flexibility:** Be ready to change when plans are not working. Do not count on stability.
- **Foresight:** You cannot predict the future, but you can hear its footsteps approaching. Think and prepare.

This article explores these characteristics as they relate to creating a financially resilient government and the central role that long-term financial planning plays in financial resiliency. The Government Finance Officers Association (GFOA) interviewed officials at several local governments that have been practicing long-term financial planning for a number of years (some as long as 15 or 20) and have, as a consequence, achieved financial resiliency.

The rest of this article will describe how long-term financial planning supports three of the most important characteristics of resiliency: diversity, decentralization, and collaboration. To read about how long-term financial planning can support all the characteristics of a resilient system, please see the GFOA's full-length report on financial resiliency at [www.gfoa.org/lftp](http://www.gfoa.org/lftp).

**Diversity.** *Avoiding a single point of failure or reliance on a single solution.*

- Keep a multifaceted perspective on financial health.
- Maintain a diversity of funds to reduce reliance on the general fund.
- Enlarge the base of supporting constituents.

The most fundamental aspect of “diversity” in financial planning is a multifaceted perspective on financial health. The viewpoint should not be limited to revenues and expenditures: land-use patterns, demographic trends, and long-term liabilities (such as pensions) must all be carefully monitored. For example, long-term financial planning has highlighted the connection between land-use policy and financial condition for many of our research subjects, thereby directly influencing land-use policies. In Florida, sales taxes are distributed by the state on a per-capita basis, rather than the point-of-sale method used in many other states. As a result, cities in Florida lack the powerful incentive for commercial development that many other cities have. The City of Coral Springs, Florida, however, has recognized that commercial properties are not sub-

ject to the same property tax restrictions as residential properties, and commercial properties therefore remain important net contributors to financial health.<sup>2</sup> This nuance has led Coral Springs to emphasize diversity in local land use, while many other cities in the area are primarily residential. In another example, the City of Sunnyvale, California, like many cities in the state, is part of the California Public Employees' Retirement System (CalPERS). Warned by CalPERS about potential rate increases, the city performed an independent analysis and discovered that it might experience a 35-45 percent increase in required pension contributions in the future. This has allowed the city to begin planning now to mitigate and absorb this risk.

Another common theme among our research subjects is diversity in the funds maintained. Different funds can be used to account for non-current liabilities such as OPEB, workers' compensation, depreciation, and replacement of assets. Self-supporting internal service funds contribute to efficient overhead services. These practices reduce the burden on the general fund and keep it from becoming a single point of failure.

Finally, Mentor Public Schools in Ohio has consciously cultivated constituent diversity. In any school district, parents in the district are going to be the most engaged constituents. Taxpayers who do not have children, however, are an indispensable source of funding. Therefore, Mentor Schools takes special care to demonstrate its financial responsibility to parents and non-parents alike, and to find out what non-parents think of the school district's performance. For example, Mentor Schools has an important pay-to-play component to its extracurricular activities (it is not 100 percent tax supported) and has been mindful of keeping its asset portfolio consistent with future service demands — for example, two properties were recently sold, thereby eliminating maintenance costs, generating a one-time revenue, and placing the property back on the tax rolls. Enhancing financial management credibility by taking highly visible actions like these enlarges Mentor Schools' base of supporters.

**Decentralization.** *Centralized systems look strong, but failure is catastrophic.*

- Make managers manage their cost and revenue structures.
- Engage departments in identifying issues, analyzing them, and developing strategies.
- Engage departments in financial modeling and forecasting.
- Develop an organization-wide strategic framework that departments can innovate within.

Decentralization is about engaging operating departments in financial planning so all departments think more strategically about finance. Long-term financial health does not rely solely on the efforts of central administration.

The bedrock of decentralization is for all departments to be responsible for their own budgets. For instance, a large county in the western United States made

departments more responsible for program revenues by directly linking their program revenue income to budget allocations. A Midwestern city was having trouble controlling overtime, so it moved all funding for overtime into a central budget. Departments then had to manage their overtime requests more carefully because all overtime was drawn from a single, more transparent funding source.

Sunnyvale goes beyond these fundamental steps by making departments fully responsible for their long-term cost

and revenue structure, including the operating impact of proposed capital projects. In fact, there was recently a high level of interest in a new park in the community, and the recreation director was one of the most vocal advocates of putting a long-term maintenance funding strategy in place before committing to building the park.

With this basic ethos of making managers manage their budget in place, it becomes possible to take a decentralized approach to financial plan development. Through its financial planning process, the finance and operating staff at the City of San Clemente, California, identifies a number of "critical issues" that could affect the future financial health of the city. A number of cross-functional "issue teams" are then formed to analyze each issue and suggest strategies. San Clemente has found that staff members are eager to participate on the teams (some even requesting a spot a year in advance) because they know the decisions made during the planning

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process are important and positive involvement is a key to advancement at the city. The consistent and meaningful involvement of departments in identifying issues, analyzing them, and developing strategies is a recurring theme in financially resilient governments.

Engaging departments in financial forecasting and modeling is an underappreciated practice — it hones their understanding of financial condition, and, hence, their perception of the need for a solid, long-term financial strategy. It also improves the quality of the forecast. Hanover County, Virginia, realized that the new economic reality made historical data less useful than it had been in making projections. Qualitative judgment was more important than ever. The county formed cross-departmental teams to examine major revenue sources and develop key forecast assumptions. For example, community development, economic development, and assessor personnel were all involved in analyzing the property tax.

Finally, and perhaps most importantly, long-term planning fosters a strategic framework for creating value for the public through government programs. The long-term plan articulates the service objectives the government is striving for and defines the parameters within which the government will pursue these objectives. Departments can then develop their own plans and budgets, yet remain aligned with the big picture. A plan drives action and prevents paralysis by analysis or inertia. The plan grants permission to try new things to further the plan's objectives.

All these characteristics promote the innovation needed to adapt to changing financial conditions. When it is accepted that everyone is working toward the same objective, innovation is more likely because commonality of purpose makes "failure" permissible — if the innovation was intended to achieve a high-priority strategic goal, then the effort is respected.

As an illustration of how planning can create shared goals, Hanover County has found that its planning process has been very important in creating value for teamwork across departmental lines. In Hanover, objectives are established through the planning process, and reliable information about the objectives and financial conditions is then disseminated. The county then works on creating communication channels across departmental lines where information sharing is important. For example, training and professional development is often one of the first expenditures to come under pressure during a revenue downturn, yet training is a primary

source of the innovations needed to improve cost-effectiveness. Hanover has used its planning process to establish and support an objective for high-quality professional development across the organization, including encouraging joint training opportunities across departments.

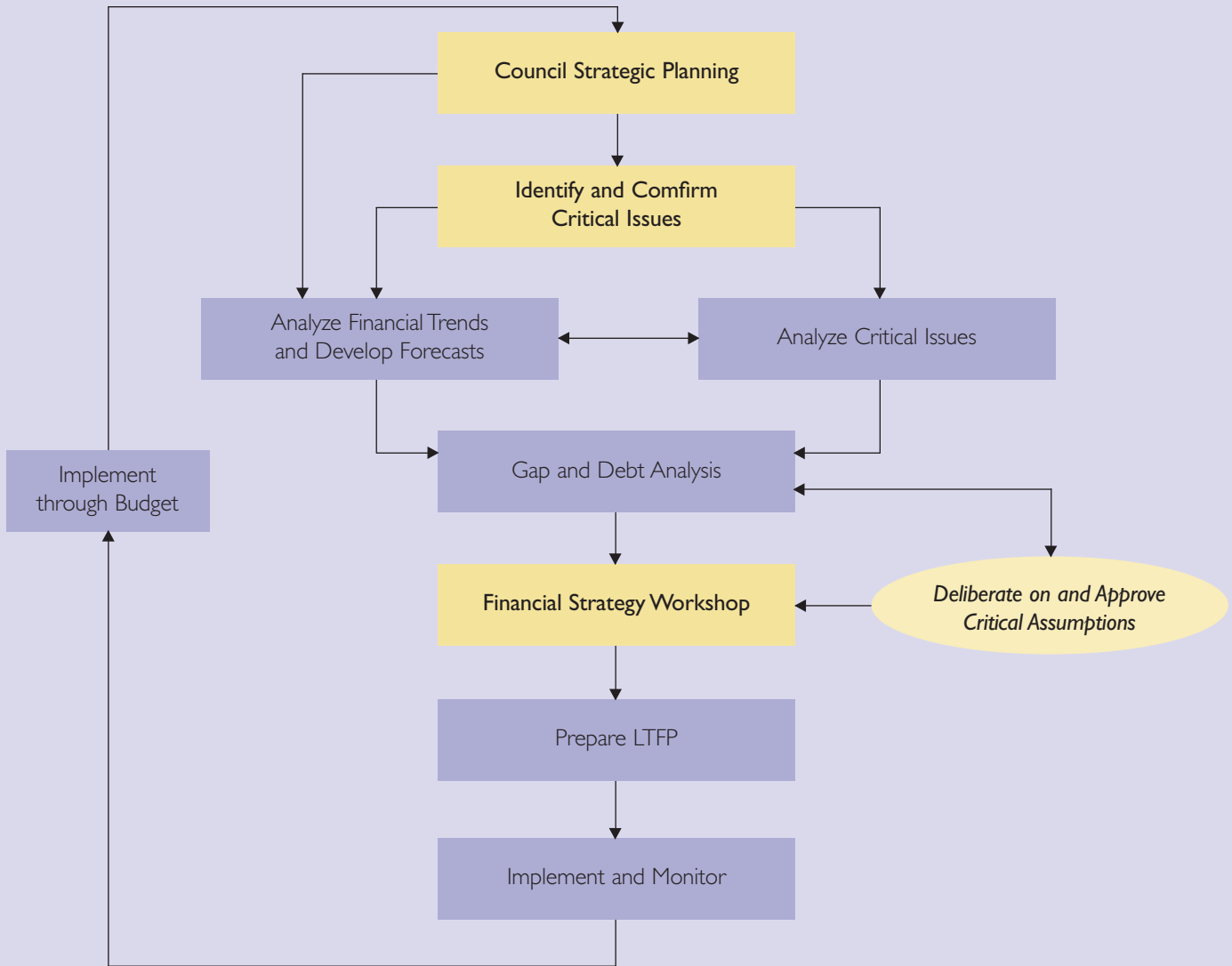
**Collaboration.** *Working together to become stronger.*

- Build the service priorities of elected officials into the plan.
- Give elected officials a role in the planning process that they can thrive in.
- Orient elected officials to the planning process.
- Use key indicators to help elected officials stay abreast of financial condition.

Elected officials have an incalculable impact on financial health because they have the final say over tax policies and budgets. Therefore, resilient governments have close collaboration between elected officials and staff. It helps both groups become more savvy financial decision makers, to better recognize problems, and to enact appropriate solutions.



## Exhibit I: Council Involvement in San Clemente's Planning Process



The first step is to engage elected officials by building their service priorities into the financial plan. In addition to demonstrating that the plan is relevant to their service goals, this step provides a common basis for participation in the planning process. Although not every official will be comfortable discussing financial issues, all can discuss and appreciate service issues.

The next step is to give elected officials in a role in the planning. Exhibit 1 provides an overview of San Clemente's planning process. The shaded boxes are

crucial points of elected official involvement. The Council sets service goals through strategic planning, helps to identify issues that affect the financial health of the city, and reviews and approves the critical assumptions behind the staff's suggested financial strategies — assumptions that will shape how the annual budget is developed.

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When new officials are elected, they must be introduced and acclimated to the planning process. Resilient governments have a formal orientation program and provide periodic refreshers.

San Clemente, for example, has an annual compliance self-review of its financial planning portfolio. The city has found that this is a good way to keep elected officials engaged with these fundamental precepts of good financial stewardship. In addition to these formal mechanisms, regular one-on-one meetings on financial issues give officials a chance to ask questions that they might not be comfortable asking in a public meeting. The impact of all of these efforts is to create a culture on the governing board in favor of financially resilient decisions. Once in place, the culture can become self-sustaining as new officials are subject to peer pressure and existing officials take their own actions to promote resiliency (such as Sunnyvale's aforementioned charter amendment, which was driven by public rather than staff action).

Finally, key indicators of financial condition should be established and communicated to help elected officials remain confident that they have a handle on financial condition. Mentor Public Schools, for example, keeps its board up-to-date on three key indicators:

- Percentage of budget spent on personnel (with 85 percent as an upper threshold).
- Recurring revenue versus expenditures (including biannual forecast updates).
- Enrollment trends versus staffing (keeping student to staff ratios consistent).

## CONCLUSION

Financial resiliency is essential to continuing a consistent program of public services despite the current volatile economic environment. A number of local governments from across the country have achieved financial resiliency and realized benefits such as top bond ratings and a soft landing in the current recession. Most importantly, though, these governments have been able to maintain the trust and confidence of their constituents and continue to create value for the public through government action. ■


### Notes

1. Jamais Cascio, "The Next Big Thing: Resilience," *Foreign Policy*, May/June 2009.
2. "Net contributor" means that a constituent contributes more in tax revenues than he or she uses in services.

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