STATE CFOs:
SURVIVING IN THE NEW ERA
About the Association of Government Accountants
The Association of Government Accountants (AGA), founded in 1950, is the educational organization dedicated to the enhancement of public financial management. The AGA serves the professional interests of state, local and federal financial managers who are responsible for effectively using billions of dollars and other monetary resources every day. The association has more than 15,000 members, including professionals in accounting, administration, auditing, budgeting, consulting, grants, fraud investigation and information technology. The AGA has been instrumental in developing accounting and auditing standards and in generating new concepts for the effective organization and administration of financial management functions. The association conducts independent research and analysis of all aspects of government financial management. These studies, including the 2011 AGA Chief Financial Officer (CFO) survey and more than 20 independent studies supported by the Corporate Partner Advisory Group, make AGA a leading advocate for improving the quality and effectiveness of government fiscal administration and program performance and accountability. For more information, please visit our Web site at www.agacgfm.org.

About the National Association of State Auditors, Comptrollers and Treasurers
The National Association of State Auditors, Comptrollers and Treasurers (NASACT) is an organization for state officials who deal with the financial management of state government. NASACT’s membership comprises officials who have been elected or appointed to the office of state auditor, state comptroller or state treasurer in the 50 states, the District of Columbia and U.S. territories. NASACT was founded in 1915 to allow principal state officials concerned with state financial management to gather annually and discuss problems and issues of mutual interest. Over the years, state financial management has become increasingly complex, and in response, NASACT has grown to address new needs by offering increased levels of service, training and networking. Visit www.NASACT.org.

About Grant Thornton LLP Global Public Sector
Grant Thornton’s Global Public Sector, based in Alexandria, Va., is a global management consulting business with the mission of providing responsive and innovative financial, performance management and systems solutions to governments and international organizations. The people in the independent firms of Grant Thornton International Ltd provide personalized attention and the highest-quality service to public and private clients in more than 100 countries. Grant Thornton LLP is the U.S. member firm of Grant Thornton International Ltd, one of the 6 global audit, tax and advisory organizations. Visit www.grantthornton.com/publicsector.
Executive summary

The Association of Government Accountants (AGA), the National Association of State Auditors, Comptrollers and Treasurers (NASACT) and Grant Thornton LLP carry out an annual survey of government financial executives and managers. The full 2011 survey, CFOs: Surviving in the New Era, reports on 1,385 online and in-person interviews with federal, state, territorial and local financial professionals, including 38 Canadian officials. The main report of the survey appeared in July 2011 and looks at both U.S. federal and state government. State CFOs: Surviving in the New Era is a more indepth look at the issues facing 40 state and territorial auditors, comptrollers, treasurers and other financial executives and 393 financial managers.

**Risk management**

A large majority of state and territorial financial executives and managers say there is adequate risk management (RM) in place for their organizations' top 3 or 4 goals. However, they give their organizations a C or C+ score for integration of RM with internal controls (IC). Reasons for integration problems include operations managers' lack of interest in IC and variations in agency-level application of IC in accounting systems. Those who give high scores to integration report using comprehensive entity-wide risk management approaches tied to strategic plans, goals and objectives that they assess regularly.

**Budget cuts**

Eight out of 10 financial managers say that recent and future budget cuts will produce new kinds of risks, including to the effectiveness of IC and RM activities; government missions, services and performance; and recruiting and retaining top employees. As the national economy recovers, state governments will once again lose the competition to attract and retain qualified financial professionals, who instead will go to the private sector. Financial executives say that 3 areas will be most affected by budget reductions: innovation, especially related to financial management information technology; ability to obtain federal funds; and the number and quality of audits and auditors.

Financial managers say they would like to cut costs by (in order) reducing staff costs, automation and reengineering. They think that governments should cut unneeded or duplicative programs, work and financial reports; consolidate business functions and information systems; and keep high bond ratings high.

**Managing state debt**

State financial executives give their state governments a C+ for how they manage state debt. Suggested ways to improve debt management are to centralize it within state government, to have a long-term fiscal plan and to make the debt issuance and management process more transparent.

**Retirement and health benefit systems for public employees**

Financial executives give their state governments a B score in state employee retirement and health benefit systems. They would like to de-politicize contribution decisions and policies for retirement plans and make the decision-making process more transparent. Ultimately, solutions for the financial future of retirement plans rest with state legislatures; financial executives must ensure that elected officials understand the implications of deferring the funding of long-term pension obligations and changing benefit levels.

Health benefits for current and retired employees represent a significant portion of personnel costs to most governments, many of which are starting to re-examine the benefits they provide now and try greater cost sharing of premiums and copayments with workers, higher deductibles and other ways to lower employee health expenses. In the long-term, though, solutions to rising health costs will depend more on societal and political factors rather than anything state governments can do.
Introduction

This is the first year that the National Association of State Auditors, Comptrollers and Treasurers (NASACT) and the Association of Government Accountants (AGA) have developed a special survey report on state and territorial government financial management from the national annual Chief Financial Officers (CFO) survey. This new survey report, State CFOs: Surviving in the New Era, is a tool for government officials to use to understand and meet the challenges of sustaining state services and sound stewardship during a period of constrained budgets. Although each state is unique, there are common themes that flow through all their governments: revenues, expenses, budgets, personnel, capital needs, benefits, services, constituents, citizens and the looming problem of debt.

In this survey, you or your colleagues in state government helped us take the pulse of those skilled professionals whose training and experience empower them to deal with public sector fiscal challenges. Through the survey, these executives and managers share ideas, common interests, pain points and frustrations they experience in order to sustain the quality and quantity of government services. All state government financial executives and managers will benefit from this shared knowledge.

Our report focuses on four important areas: risk management, budget cuts, debt management and employee benefits. We also outline what state financial executives think are their chief challenges over the next 2 years and how they plan to deal with them. Look at the solutions offered, adopt those that fit and make them even better.

To obtain electronic copies of the full series of annual CFO surveys and their respective survey instruments, visit www.grantthornton.com/publicsector under Publications.

Table of contents

Executive summary ............................................................... 1
About the survey ................................................................. 3
Risk management ................................................................. 5
  Assessment of risk management ........................................... 5
  Integration of internal controls and risk management .......... 6
  Training in risk management .............................................. 8
Budget cuts ........................................................................ 9
  Effect of cuts .................................................................... 9
  Where to look for savings ................................................... 10
  Helping nonfinancial operations achieve savings .............. 12
Managing state debt ............................................................. 13
  How states manage their debt ............................................ 13
  Improving the debt management process ......................... 14
Retirement and health benefit systems for public employees ... 15
  Retirement plans and their management ............................ 15
  Employee health benefit plans ......................................... 16
Critical challenges in the years ahead .................................. 18
  How financial professionals can help ................................. 19
Conclusions ....................................................................... 20
About the survey

The Association of Government Accountants (AGA), in partnership with Grant Thornton LLP, has sponsored an annual government chief financial officer (CFO) survey since 1996. In 2011, for the 3rd year, the AGA has joined with the National Association of State Auditors, Comptrollers and Treasurers (NASACT) to expand the reach of the survey. We also appreciate the contributions of the Government of Canada.

This is the second report that integrates 2 surveys of U.S. government financial executives and professionals. The first report, released in July 2011 and entitled CFOs: Surviving in the New Era, included data drawn from online surveys of state and territorial government officials done through NASACT, in-person interviews with their federal counterparts by Grant Thornton personnel on behalf of AGA and online polling of AGA members through the AGA Web site. The first report focused on risk management, predictive and statistical analytics, budget cuts and the federal financial reporting model.

This second report, State CFOs: Surviving in the New Era, focuses on state and territorial government officials, including those responding through NASACT and those AGA online survey participants who identified themselves as state government employees. Topics covered include:

- NASACT respondents: risk management, budget reductions, debt management and state employee retirement and health insurance systems. We refer to them as “executives” in this report.
- AGA members who are state government professionals: risk management and budget reductions. We refer to them as “managers.”

Our purpose for doing the surveys is to identify emerging issues in financial management and provide a vehicle practitioners can use to share their views and experiences with colleagues and policy-makers. This is one way that NASACT and AGA maintain their leadership in governmental financial management issues.

Anonymity

To preserve anonymity and encourage respondents to speak freely, the annual surveys of the financial community do not attribute thoughts and quotations to individual financial executives who were interviewed, and they do not identify online respondents.

Survey methodology

With NASACT and AGA guidance, Grant Thornton developed online survey instruments that included closed- and open-ended questions. We did non-random in-person interviews with 152 U.S. federal financial leaders (CFOs, deputy CFOs, Inspectors General and other executives) and senior leaders of oversight groups such as the Office of Management and Budget (OMB). We did nonrandom online interviews with 1,157 AGA members whose government affiliations are shown in Figure 1; of the 1,157, 34% or 393 said they worked for state government.

Figure 1: Government affiliation, AGA members responding to 2011 online survey

47% Federal
3% Other
15% Local
34% State
1% Regional

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We also did a separate online survey of 40 financial officials from 28 states. Their titles include (some have the same titles):

- Acting Auditor General
- Administrative Auditor
- Audit Manager—Technical/Research
- Auditor of Public Accounts
- Auditor General
- Chief Accounting Officer
- Chief of Accounts
- Chief Operating Officer —State Accounting
- Comptroller of Public Accounts
- Controller
- Deputy State Treasurer
- Director of Accounting
- Director of Audits
- Director of Fiscal Management
- Director of Strategic Planning and Performance Management/Legislative Liaison
- Director Research and Professional Development
- Examiner of Public Accounts
- Executive Deputy Comptroller
- Legislative Auditor
- Public Auditor
- Senior Executive Policy Coordinator
- State Accounting Division Administrator
- State Auditor
- State Controller
- State Treasurer
- State Accounting Division Administrator
- Technical Manager

The 40 state survey respondents represent 28 states and territories:

1. Alabama
2. Alaska
3. Arizona
4. Colorado
5. Connecticut
6. Georgia
7. Guam
8. Iowa
9. Kentucky
10. Maryland
11. Michigan
12. Minnesota
13. Missouri
14. Montana
15. Nebraska
16. Nevada
17. New Hampshire
18. New York
19. Oklahoma
20. Oregon
21. Pennsylvania
22. Rhode Island
23. Tennessee
24. Texas
25. Virginia
26. Washington
27. Wisconsin
Risk management

Governments, industries, economies, societies and whole ecosystems exist in a dynamic environment. That dynamism means that the future is, to some extent, uncertain.

Assessment of risk management
We asked state government financial executives and managers whether their government organizations have adequate risk management for the entities’ top 3 or 4 goals and show the results in Table 1.

Table 1: Does your organization have adequate risk management in place for its top 3 or 4 goals?

<table>
<thead>
<tr>
<th>Response</th>
<th>Executives</th>
<th>Managers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>71%</td>
<td>77%</td>
</tr>
<tr>
<td>Maybe</td>
<td>4%</td>
<td>4%</td>
</tr>
<tr>
<td>No</td>
<td>25%</td>
<td>19%</td>
</tr>
</tbody>
</table>

Defining risk and risk management

Risk: The effect of uncertainty on objectives

Risk management: Coordinated activities to direct and control an organization with regard to risk


Enterprise risk management: “A process, effected by an entity’s board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives.”

When asked what role their financial management offices play in assessing and managing risks for the 3 or 4 top goal areas, executives reported the following activities:

- Carry out internal audits and activities related to them
- Evaluate areas for the purpose of establishing risk management and internal controls that will provide adequate coverage and not expose an entity to unnecessary risk
- Establish risk management and internal control standards to be followed by state agencies
- Document and review completion of risk management and internal control tasks by other state entities
- Coordinate the agencies’ reviews of risk management relative to objectives in strategic plans, which may lead to changes to the plans and their related activities
- (For state auditors) Consider risks that affect financial audits and recommend improvements to relevant risk assessment activities
- Provide input through budget reviews and audits

Managers report a similar list of risk management activities for their offices, shown in order of the frequency of their mention:

1. Manage risks by identifying, assessing, mitigating and monitoring them
2. Develop, update and enforce internal controls
3. Conduct annual and periodic reviews of risk assessments and processes
4. Conduct internal audits, some focusing only on high-risk areas
5. Prepare risk control plans and provide information on risk control policies

**Integration of internal controls and risk management**

An entity’s internal control activities should be integrated in its enterprise risk management (ERM) activities, but this is not always the case. Risk mitigation strategies on the program or operations side of an entity are rarely informed by the internal control work done on the financial side. This may reflect the siloed nature of many public sector organizations or simply a lack of understanding that financial and nonfinancial risks go together.

For example, of executives who commented on the topic, most said their primary contribution to ERM is through internal controls over financial transactions. We asked U.S. federal and state executives and managers how well satisfied they were with how their entity integrates risk management in general with its internal controls and show the results in Table 2. On a scale of 1 to 5, with 1 being very dissatisfied and 5 very satisfied, federal and state executives scored an average of 3.1 and 3.5, respectively, while managers at the federal, state and local/regional level scored 3.5, 3.6 and 3.5. Passing grades, but nothing stellar.
Here is a sampling of comments from state executives at different scoring levels:

**Level 1.** (No comments)

**Level 2.** “We have a very difficult time convincing program managers that internal controls are as much or more their responsibility as they are of the state- and department-level controllers.”

**Level 3.** “We are a combination of a centralized accounting system with decentralized agencies. Many of the internal controls are built into the accounting system but may be subject to agency override because of the decentralized structure. With the changes in audit standards, the legislative auditor’s office no longer performs much of an internal audit function and there has been little support for adding internal auditors to fill this gap.”

**Level 4.** “We have good coordination between the state auditor and the state accounting officer.”

**Level 5.** “My state passed an act that requires an entity-wide risk management approach similar to COSO 1 and 2. This is an entity-wide and activity/program risk assessment process and includes annual self-assessment. We start looking at our strategic plan’s mission, goals and objectives. We then identify risks by magnitude and likelihood that they could prevent us from achieving goals and objectives. For those risks that cannot be prevented, we identify and implement internal controls to mitigate them.”

Comments by managers at different scoring levels include:

**Level 1.** “The entity has not implemented an ongoing risk management process.”

**Level 2.** “There is a disconnect between risks and controls; controls are often thought of in a traditional way”

**Level 3.** “We usually establish internal controls reactively, not proactively.”

**Level 4.** “Internal controls are assessed within the risk management process”

**Level 5.** “We have a comprehensive internal control policy as well as a policy for those outside of our agency using services we provide.”

Getting people to accept risk management remains an issue, say several managers such as this one: “I think that for risk management to be effective, there has to be top-down ‘buy in’ for it. Internal controls are a part of that, but seem to be more an option rather than a requirement.”

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**Table 2:**
Executives and managers’ satisfaction with integration of risk management with internal controls

<table>
<thead>
<tr>
<th>U.S. Government</th>
<th>Mean satisfaction score on 1 to 5 scale*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal executives</td>
<td>3.1</td>
</tr>
<tr>
<td>State executives</td>
<td>3.5</td>
</tr>
<tr>
<td>Federal managers</td>
<td>3.5</td>
</tr>
<tr>
<td>State managers</td>
<td>3.6</td>
</tr>
<tr>
<td>Local/regional managers</td>
<td>3.5</td>
</tr>
</tbody>
</table>

*1 = very dissatisfied, 5 = very satisfied

Training in risk management
We also asked state executives to rate their satisfaction with their and others’ training in risk management skills on a scale of 1 to 5, with 1 being very dissatisfied and 5 being very satisfied, and show the result in Table 3 below.

Table 3: State financial executives’ opinions of their own risk management skills and those of financial managers and of nonfinancial managers

<table>
<thead>
<tr>
<th>Position</th>
<th>Mean satisfaction score on a 1 to 5 scale*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Executive</td>
<td>3.8</td>
</tr>
<tr>
<td>Financial managers</td>
<td>4.0</td>
</tr>
<tr>
<td>Nonfinancial managers</td>
<td>2.9</td>
</tr>
</tbody>
</table>

*1 = very dissatisfied, 5 = very satisfied

State managers’ opinions of their own skills in risk management were roughly in line with those of the executives. About 6 in 10 state managers say they are satisfied with their training and skills in this area, 2 in 10 are not satisfied and the balance did not know. Some of the managers’ comments include:

- “Professional training and certifications are part of the risk management program on a continuing basis as long as funds are available.”

- “My training and educational background and experience give me adequate ability in this area. However, risk management is an evolving area that will always require a financial career to continue and maintain education and training to stay abreast.”

- “I would like to have more tools for assessing the risk assessments themselves so that they are more meaningful and easy to understand.”

As shown in Table 3, many executives are dissatisfied with both the training and the attitude of nonfinancial professionals when it comes to risk management. Says one executive, “Nonfinancial managers routinely elect to ignore risks until they are unavoidable. In addition, they perceive the controller function as ‘causing’ the resulting problems by speaking about and attempting to address expected or potential risks.” Another says, “My state’s career development programs for executives and managers do not include risk management. Further, risk management is not [considered] a core competency for these leadership positions.”

Several managers noted the importance of having nonfinancial managers take risk assessment training; this includes training offered in connection with obtaining Project Management Professional (PMP) certification. A few said that their financial executives and senior managers would benefit from more training in risk management as well.
Budget cuts

In an earlier section on risk management, we discussed the potential effects of budget constraints on various risk-related activities. Here, we look at other areas where survey respondents say that recent and future budget cuts will degrade performance in financial management. At the same time, tight budgets can increase the influence of the savvy CFO who can help hammer the most value out of every dollar of revenue.

Effect of cuts
We asked state financial managers what they thought would be the overall effect of budget cuts. One summed things up this way: “There will be little impact in the short term, and maybe mid-term degradation in accuracy, timeliness and service will be acceptable. But we cannot keep the dam from bursting forever.” As shown in Figure 2, about 8 out of 10 state managers think that budget cuts will mean new kinds of risks for their governments financial and operations activities.

Figure 2:
State financial managers’ opinions on the likelihood that budget cuts will impose new types of risks to nonfinancial operations and mission

State managers say the top 3 risk areas are:

1. **Internal controls/risk management:** “As the availability of fiscal experts to oversee and monitor fiscal activities decreases, the ability for fraud waste and abuse to become more prevalent increases,” says a state manager. “Budget reductions can increase risk related to employee manipulation of funds, for instance, excessive or fraudulent travel that results in per diem payments to that employee. Budget reductions also increase manager shortages; thus certain risks may be exploited,” says another.

2. **Mission/Services/Performance:** Says a state financial manager involved in criminal justice, “Continued budget cuts will cause mandatory reduction in services offered and eventually a reduction in managers. In our organization, we analyze evidence for the court system. We run the risk of not having the evidence ready and criminals remaining on or returning to the streets.”

3. **Personnel:** The 2 top risks to operations and mission stem from the assumption that personnel cuts will reduce the ability to provide services when needed. Other problems caused by personnel reductions include, according to state managers:
   - Inability to provide segregation of duties that could result in a lack of internal controls and oversight, which could lead to errors or fraud.
   - “Recruiting and retaining top employees is not easy when you have little to offer so there is always the risk that managers will be less skilled than needed,” says a state manager. (State CFOs who a few years ago told us that they had an influx of CPAs and other financial professionals from a private sector that was shedding jobs now
fear losing these highly trained staff members as the industry job market heats up while government’s cools down.)

We also asked state financial executives where they thought that budget reductions would have the most effect on financial and nonfinancial operations, and 3 areas stood out: innovation, loss of funds and audits.

1. **Innovation.** Low-cost innovations have mostly been tapped out, say some state executives. These include business process improvements that do not depend on IT, such as streamlining and re-engineering. That leaves innovations that require heavy capital investment. They will likely be put on hold unless there are compelling reasons that involve either saving large amounts of money or (more likely) losing large amounts for lack of compliance with funding sources. Managers’ cuts not accompanied by workload cuts often leave IT as the only realistic solution, and IT innovation is expensive.

2. **Loss of funds.** State financial executives say that they could end up losing federal funds if they cannot comply with federal reporting and other requirements that accompany the money. According to a state financial executive, “The most significant areas where financial management budget reductions would have adverse impacts are loss of budgetary control, failed financial reporting that results in credit rating reduction, inaccurate payments to vendors and employees and loss of federal grants and U.S. Internal Revenue Service (IRS) debt service subsidies because of poor grant reporting and compliance with Securities and Exchange Commission and IRS reporting.” Says another state executive, “If we provide fewer financial services and other support services to operational divisions, then nonfinancial personnel will either need to do work for which they lack the training and skills or they will simply not do it at all. This increases financial management risk and ultimately services to citizens.”

3. **Audits and auditors.** Auditors may be hard hit, too, says a state executive: “In tight times there are more audits and more attention to auditing and accounting standards. That means that reductions in audit managers would present great challenges for us to meet required audit procedures and deadlines, which means less accuracy. Also, federal rules and regulations with which we have to comply create exponential challenges for us to meet deadlines with fewer resources.”

**Where to look for savings**

According to state financial managers, the areas of their financial operations that they would look to first to achieve savings are, in order:

1. Reduce staff costs, including number of staff or salaries, benefits or hours
2. Automate processes, go paperless and make better use of information technology
3. Re-engineer processes
4. Improve purchasing of equipment and supplies.

For financial executives, here is a laundry list of the first areas they would look at for savings:

- “Eliminate operations and support programs that are no longer relevant; improve the effectiveness and efficiency of those that are relevant. For tools to do this, use independent performance audits, management studies, Lean principles, re-engineering and business
analytics. Keep these procedures transparent because bureaucracies are quite effective at preserving the status quo.”

• “Reduce unneeded or duplicative work, including in financial reporting.”

• “Consolidate accounting functions across agencies, especially the smaller ones.”

• “Cut travel and supplies and use more Web-based training instead. We may also provide less customer service to agencies by doing fewer agency visits.”

• “Having just made a big investment in technology, we need to find the time to start using more of its functionality to achieve more efficiency.”

• “Savings must initially come from areas that are less susceptible to immediate repercussions, such as new initiatives and oversight.”

• “We would reduce personnel and consolidate more services.”

• “Cut unfilled positions permanently instead of terminating filled staff field positions.”

• “Start with administrative costs: consolidate assistant positions and office equipment; lease vehicles instead of paying monthly mileage expenses; self-insure vehicles; reduce leased office space; and require employees to take accumulated leave regularly to reduce compensated absences liability.”

• “Reduce contracting for goods and services.”

• “Re-engineer the budget process.”

• “Establish a single statewide information system in order to improve reliability and cut the cost of providing information to decision-makers.”

• “Reduce improper payments and transaction processing errors.”

• “Target health care and pension costs.”

• “Maintain the state’s AAA bond rating.”

• “Keep staff well trained and compensated in order that they can capture innovations.”

• “Do electronic payments without sending advices – do not let payees have a choice in the matter.”

• “Increase the use of transactions on purchase card, which reduces staff time and material costs and increases rebates received from the card issuer.”
Like managers, executives mentioned automation and IT as major money savers. The Catch-22 is that new IT costs money that states may not have at this point. Creative partnerships with vendors could help alleviate this, as would maximizing the use of existing technology.

Perhaps the best way to save money, say several financial executives, is simply not to do work that does not need to be done, or at least set priorities so that resources focus on critical projects and reports. Says an executive, “Too much of our low-priority work generally has to do with compliance with state laws that the legislature is unwilling to remove, even though it knows this will save costs.” In a severe budget crunch, say some state audit executives, they will have to start eliminating audits and attest work not required by state statute or federal regulations.

**Helping nonfinancial operations achieve savings**

State financial executives offer the following ideas for helping their nonfinancial colleagues to achieve savings:

- Give budget offices comparative data so that they can set priorities for budget reductions.
- Get the right financial information to decision-makers — make this useful, practical information for improving financial and nonfinancial services, and make sure that officials clearly see the link between efficient, effective program delivery and resource allocation.
- Make sure that agencies stay within budget.
- Keep statewide financial management requirements, risk management and internal controls reasonable and cost effective and assist with their effective implementation and oversight.
- Maintain reasonable prices for financial services offered by central offices.
- Explore opportunities for outsourced financial services.
- Help agencies with risk management and internal controls.
- Take charge of finding the best ways to cut operational costs while still meeting organizational goals.
- Train nonfinancial managers in appropriate and effective financial management methods (performance measurement, cost accounting, business analytics).
- (For treasuries) Speed up payments and collections.

About 80% of financial executives in the survey say their managers have the training and skills to assist nonfinancial operations in dealing with budget reductions. About 75% of managers agree with this, 20% do not and 5% are not sure. Areas in which financial executives think they and their managers need more training in order to assist nonfinancial professionals include effective ways to communicate with nonfinancial managers, legislators and budget officers; strategic planning; change management; budget processes; and technology efficiency initiatives, benchmarking, performance measurement, risk management, cost accounting, predictive and statistical analytics and balanced scorecards.
Managing state debt

This section concerns government or public debt, which is money or credit owed by a government. In 2008, per capita state debt varied from below $1,000 in one state to nearly 12 times that in another. Bankruptcy is not an option for states because they are sovereign entities and all states strive to have AAA bond ratings from leading investment analysts. However, state bond ratings could change with the economy, with tax and spending policies and with the United States’ credit rating and the federal budget. Therefore, debt management has to be a critical issue for state government and for NASACT members.

State financial executives give their state governments an average rating of 3.6 out of 5 for how the governments manage their debt, with 1 being very unsatisfied and 5 being very satisfied; this is equivalent to a C+ academic score.

**How states manage their debt**

When asked what governs the issuance of debt in their states, about 86% of state financial executives said it was done by statute, 81% by the state constitution and 43% by policy (the figures add up to more than 100% because most states’ debt is governed in several ways). As shown in Table 4, just over half of the respondents say that their states have a system of central management for debt, so that they or another central office or authority controls or coordinates both the issuance and management of revenue bonds and other debt instruments. Another third have a mixed system that is both centralized and decentralized, with both a central agency and individual agencies managing debt. About 15% say that debt management is decentralized, meaning that individual agencies and authorities manage their own debt.

Eight out of 10 financial executives say that their state has dedicated or specialized debt management organizations, such as a division, office or department. These range from public authorities, such as the treasury and related boards, a state funding board, a capital finance office, a division of bond finance, specialized authorities or a legislative finance committee.

Three out of 4 executives say there is an individual who is the official debt manager for the state; sometimes, this is the state treasurer. In general, debt managers have a degree in finance or accounting and extensive experience in bond issuance and managing government debt, according to financial executives in the survey. In addition, almost all executives reported that

<table>
<thead>
<tr>
<th>Centralization of debt management</th>
<th>Percentage of executives responding</th>
</tr>
</thead>
<tbody>
<tr>
<td>Centralized</td>
<td>55%</td>
</tr>
<tr>
<td>Decentralized</td>
<td>15%</td>
</tr>
<tr>
<td>Both centralized and decentralized</td>
<td>30%</td>
</tr>
</tbody>
</table>
their state uses a financial manager to advise on actions affecting debt issuance; some also use a bond counsel. These can be either government employee or contractor positions.

Improving the debt management process
State financial executives offer several suggestions for improving their states’ debt management. Says an executive with a decentralized debt issuance and management system, “The effect of this decentralization has been adverse because each issuing state agency has to learn the entire process from scratch and is at the mercy of the private sector debt issuance professionals, such as bond lawyers, disclosure counsel, financial analysts, underwriters, etc. This is unconscionable for an entity the size of my state. We need to centralize debt management, require a statewide debt management policy and remove that policy from the political process. Instead, we need to institutionalize the policy within the bureaucracy to ensure continuity and compliance.”

Funding current operations through long-term debt is a problem, say several executives, while another says that his state needs to have constitutional debt limits. In any case, states need to have a long-term fiscal plan, says an executive. Also, the debt issuance and management process needs to be more transparent, says another.
Retirement and health benefit systems for public employees

In this section, we look at 2 areas that have been in the headlines since the beginning of calendar year 2011: public employee pensions and health insurance. These are highly politicized topics, and in some cases the responses we received reflected this. We have elected to confine the following discussion to such facts as are generally agreed to by professional associations and to focus on management issues.

Retirement plans and their management

Despite alarmist headlines, public pension plans are not causing a crisis right now. However, there is a need to manage such benefits carefully over the coming decades. According to the National Governors Association, the National Conference of State Legislatures, NASACT and a host of other state and local government associations, “Most state and local employee retirement systems have substantial assets to weather the economic crisis. There is currently $2.7 trillion already set aside in pension trusts for current and future retirees. Public pensions are funded and paid out over decades; state/local government retirees do not draw down their pensions all at once.”

How states manage their retirement systems

All executive respondents to our survey say that their states have a retirement system for civil servants and non-civil servants. Asked to rate their satisfaction with their states’ retirement systems, financial executives gave them an average score

Table 5 shows the nature of the state retirement systems reported on by financial executives in this survey. In a traditional defined benefit plan, employees receive a set monthly amount upon retirement based on salary and length of service for the rest of their lives. In a defined contribution plan such as the 401k, employees put part of their salary into a retirement account through which they invested in stock, bonds, mutual funds and other assets. Some states match employee contributions to a certain percentage. There is no guaranteed payout amount in these plans. Some states operate under both types of plans for some classes of employees. Some employees fall under both types of plans, usually because at one time their state offered only a defined benefit plan but then switched to a defined contribution plan.

Table 5: Financial executives’ report of the nature of their state employee pension system plans

<table>
<thead>
<tr>
<th>Employee category</th>
<th>Defined benefit plan</th>
<th>Defined contribution plan</th>
<th>Other plan</th>
<th>Don’t know/ does not apply</th>
</tr>
</thead>
<tbody>
<tr>
<td>Civil servants</td>
<td>81%</td>
<td>5%</td>
<td>14%</td>
<td>0%</td>
</tr>
<tr>
<td>Non-civil servants</td>
<td>72%</td>
<td>17%</td>
<td>11%</td>
<td>0%</td>
</tr>
<tr>
<td>Other</td>
<td>40%</td>
<td>20%</td>
<td>20%</td>
<td>20%</td>
</tr>
</tbody>
</table>

of 4.0 out of 5, with 1 being not at all satisfied and 5 being very satisfied (see Figure 3). Asked how their states govern the retirement systems, almost all said this was the responsibility of retirement boards, most of which determined investment strategies, with the advice of civil service or contract investment experts. In several cases, the state treasurer or a central investment board, with advice from asset allocation professionals, handles retirement investments.

How to improve retirement systems
As with debt management, some executives think that retirement system management is over politicized. Says one, “Ultimate responsibility for benefits and contributions resides in the legislature, which has sometimes acted imprudently. During good times when the pension plan was fully funded, the legislature decreased employee contributions, but in bad times increased employee contributions as a way to mitigate budget shortfalls.” However, say other executives, adjusting employee and government contributions may be the only solution, and needs to be based on actuarial recommendations. In any case, more money will be needed for employee retirement, and one way to do this is to broaden investment options to get higher interest rates and returns, say several executives. According to one, “The legislature has passed rules to restrict our ability to invest in certain parts of the world for purely political reasons. If this trend continues, it becomes more difficult to reach our assumed rate of return, and could limit our investment opportunities, which would be detrimental to the plans.” Regarding economies of scale and uniformity of management, another executive suggests having a single umbrella advisory group for all plans used by a state government, rather than separate advisors for each.

As with debt management, states need to have more transparency in how they manage retirement accounts. “Legislators and other public officials would benefit more from transparent public hearings or work sessions on the financial condition of my state’s various retirement systems. Policy-makers need to understand the financial implications of deferring the funding of long-term pension obligations and of changing benefit levels — and do this publicly,” says an executive.

Employee health benefit plans
All states offer their employees health insurance, although the coverage, eligibility and cost to the state and to the employee vary. Nationwide, about 3.4 million state employees received health benefits in 2009, or about 7 million people total if one counts their families. Health benefits for current and retired employees represent a significant portion of personnel costs to most governments, many of which are starting to re-examine the benefits they provide now. States are looking at greater cost sharing of premiums and copayments with workers, higher deductibles and other ways to lower employee health expenses to government.

Among the executives surveyed, almost all report that their states self-insure for their employee health plans, including for civil servants,
non-civil servants, elected officials and retirees. A little over half of executives say that a health administrator governs these plans; most of the remainder say that a board controls them. Regarding self-insurance, one executive thinks that this method does not yield greater savings because of the cost of claims administration, which the state cannot do. “You simply cannot transfer the risk — private insurers will adjust for it through premium increases and third-party administrator fees.”

Asked to rate their satisfaction with their states’ employee health insurance systems from a financial perspective, financial executives gave them an average score of 3.9 out of 5, with 1 being not at all satisfied and 5 being very satisfied (see Figure 4). Raising performance in this area will depend more on larger-scale societal, political and cultural factors rather than any discrete thing that state governments can do, say several executives. This includes changing how the nation delivers health care and controls related costs.

Figure 4: State executives’ rating of their satisfaction with their states’ employee health insurance systems from a financial perspective

<table>
<thead>
<tr>
<th>Not at all satisfied</th>
<th>Very satisfied</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>5</td>
</tr>
<tr>
<td>2</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td></td>
</tr>
</tbody>
</table>
Critical challenges in the years ahead

A final part of our survey of state financial executives was to ask them to name and describe the most critical challenges to their governments over the next 2 years, and how financial management could help meet those challenges. Below, we list their responses in the order of frequency of mention.

Ability to deliver government services. Many executives are concerned that their governments will not be able to deliver the quantity of services to citizens that they have in the past. Both state revenue shortfalls and looming or actual decreases in federal funding are the chief reasons. This is particularly true for stimulus funding from the American Recovery and Reinvestment Act of 2009, which is starting to dry up at the state and local levels. Legislatures unwilling to raise taxes or accumulate more debt means there is likely to be no other route but to trim services.

Personnel issues. Primarily, executives are concerned that they are losing employees in the Baby Boom generation (born 1946 to 1965) to retirement, which means knowledge loss, while also losing the ability to attract and retain the skills and experience they need going forward. Part of the problem for the future workforce

Financial professional job satisfaction

We asked state financial executives and managers how much they enjoyed their current jobs, taking into account both the job’s professional aspects and the effects of it on their personal life. As shown in the table below, the great majority enjoy their jobs a lot or most of the time. This is in keeping with past surveys we have done with the Association of Government Accountants and the American Society of Military Comptrollers.

Table 6:
State executives’ rating of their job satisfaction

<table>
<thead>
<tr>
<th>Level of enjoyment</th>
<th>Executives</th>
<th>Managers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Enjoy it a lot</td>
<td>47%</td>
<td>23%</td>
</tr>
<tr>
<td>Enjoy it most of the time</td>
<td>42%</td>
<td>53%</td>
</tr>
<tr>
<td>Mixed feelings</td>
<td>11%</td>
<td>19%</td>
</tr>
<tr>
<td>Most of the time do not enjoy it</td>
<td>0%</td>
<td>5%</td>
</tr>
<tr>
<td>Do not enjoy it at all</td>
<td>0%</td>
<td>1%</td>
</tr>
</tbody>
</table>
is that, once the economy heats up again, state employment will no longer be as attractive—particularly because salaries and benefits may no longer be as competitive. Too, recent political battles have in some cases been quite hostile toward public employees and to government in general, to the point where public service may not be seen as attractive as in the past.

Setting priorities. Given the 2 just-listed challenges, it becomes more important than ever to set priorities for the types of issues that government will address and where and how it will allocate scarce resources. “We need to find ways to maintain essential services in the face of revenue shortfalls,” says an executive. This “resetting” of government at all levels, faced with both political pressure and bureaucratic inertia, may very well be the immediate challenge of the next 2 years.

How financial professionals can help
How can financial executives and managers help their governments in light of this less-than-stellar future? Here is what some executives had to say:

• Many say that their financial function budgets have been cut far too much to sustain current work levels. However, searching for ways to cut work such as unneeded activities and reports may save time and money both for financial and nonfinancial personnel.

• Financial leaders need to start anticipating the effect of future budget cuts now, instead of reacting to them once they arrive, says one executive. Then, they can help their states get ready to take the hits that are ahead.

• Good financial information always helps when setting priorities and managing tight budgets tightly, say some executives. This is a basic responsibility of government financial managers, who must now redouble their efforts to give timely and useful information to decision-makers—and show them what the data mean.

• This is as good a time as any—better than many, really—to communicate and equip nonfinancial management staff with the skills and perspectives to maintain a strong control environment, says an executive.

• Perhaps the most welcome way for financial managers to help in the current fiscal situation is to find ways to acquire more financial resources. Not quite as popular but equally effective will be to help find ways for government to do more with less without making large capital investments.

Is there a timeline for all this activity? What happens in government tends to be a lagging indicator of the economy of a nation or state. Even as the economy slowly recovers, times will remain tight for government for the near future. Therefore, if state government financial management has not yet done the work described above, the time to start is now.
Conclusions

In 2011, the State CFO Survey addressed key issues brought to light during discussions of fiscal sustainability. For state financial leaders, the best take away from the survey report is that they and their colleagues have common problems and that there are solutions to most of them. If nothing else, the survey results should prompt discussions within and between states on how best to face the future.

**Risk management**
Risk management and internal control are becoming even more important than in the past because of shrinking budgets. State governments need to put more effort into integrating RM and IC activities and to helping all public officials understand the value of both. Risk management is an evolving discipline, so financial professionals must make extra efforts to stay abreast of the latest developments in this area.

**Budget cuts**
Many state government financial offices have already been cut to the bone, yet are being called upon to deliver the same or even greater services. For them, doing more for less is virtually impossible, so they must instead do less for less. Things that should be put aside include unnecessary or duplicative reports and activities. Financial managers can help their non-financial colleagues meet budget shortfalls by finding new revenue sources, providing timely, useful information for decision making, training them in financial tools and participating in efforts to reduce operational costs.

**Debt management**
Centralizing a state’s debt management may help cut administrative costs and increase efficiency; politically, this may be difficult but it is an avenue worth exploring. In any case, state financial leaders should strive to help their governments develop a long-term fiscal plan and to make the debt issuance and management process transparent.

**Employee benefits**
Some states will benefit from less political and more institutional control and decision making over public employee benefits such as retirement and health care systems. At the least, financial executives need to ensure that elected officials understand the full implications of their fiscal decisions concerning such benefits.

Financial leaders need to start anticipating and planning for future budget cuts now, instead of reacting to them once they arrive. They are the state leaders who are best equipped to bring a forward-looking and objective perspective to the fiscal challenges ahead.
Additional Information

If you would like more copies of this survey or an opportunity to hear more about its content and the challenges facing the CFO community, please contact the Association of Government Accountants or the National Association of State Auditors, Comptrollers and Treasurers at the addresses below:

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