



State of North Carolina Legislative Services Office

Information
For:

Statewide Performance Audit

RFI

S.L. 2006-248 the Studies Act of 2006

Due Date: October 31, 2006

Aaron A. Estis, President
The ESTIS Group, LLC

October 31, 2006

Legislative Services Officer
Room 2129 Legislative Building
16 West Jones Street
Raleigh, NC 27601-1030

To Whom It May Concern:

The ESTIS Group is pleased to respond to your request for information regarding the North Carolina Legislature's interest in conducting a statewide performance audit.

My company, The ESTIS Group, is a relatively new, but I have had extensive experience conducting statewide performance audits and management reviews. I participated in the North Carolina performance audit as an employee of KPMG and was part of the leadership team for the statewide reviews in Kentucky, Louisiana, Mississippi, Pennsylvania, South Carolina, and Georgia.

This response includes information on four of the projects I participated in and my reflections on them. It provides some general recommendation on going forward including the importance of top level support, state employee participation on the project team to ensure knowledge transfer, the use of policy analysts to staff the effort, and employing the Enterprise Business Architecture tool to map state functions.

The ESTIS Group is interested in assisting North Carolina with its statewide performance audit. Although we may not have the resources necessary to staff the entire project, we can be of assistance with discrete projects associated with the audit or we may participate on a larger team.

If you have any questions regarding the information provided in this response, please give me a call at 404 964 9992.

Yours,

Aaron A. Estis, President
The ESTIS Group

Table of Contents

Introduction	4
Assessment of Selected Performance Reviews	4
Washington DC.....	4
Kentucky.....	6
Louisiana	7
Georgia I and II.....	8
Georgia I – Statewide Audit 2000.....	8
Georgia II -- Commission for a New Georgia 2004.....	10
A New Approach for Statewide Reviews	12
Key Decision Areas for the Approach	12
Project Standards.....	12
Resources	12
Project Approach.....	13
Enterprise Business Architecture	13
Policy Analysts.....	14

Introduction

Periodically, governments engage in broad reviews of their operations and policies to identify ways to improve performance and outcomes for their citizens. At the federal level these types of studies have been conducted nearly every 10 to 15 years since the beginning of the 20th century -- the most recent being the national performance review headed by then Vice-President Al Gore. State and federal comprehensive management and performance reviews are often initiated when administrations change. This is especially the case when the new administration is of a different party than the last administration.

The North Carolina Performance Audit of 1991 generated a wide range of recommendations for changes in the way the state does business. Many of the recommendations were implemented and yielded their desired effect. Fifteen years later things are different. There are new opportunities for leveraging technology and industry best practices to benefit North Carolina Government and the citizens of the state. A comprehensive review of executive branch operations will produce new recommendations and new opportunities for the state.

North Carolina not only has the benefit of its own experience, but can now draw upon the statewide performance audits, management reviews, and studies that have occurred in neighboring states over the past 15 years. This request for information will generate input that can help the Legislative Services Office structure a request for proposals to its best advantage and one that encourages qualified companies to bid.

Assessment of Selected Performance Reviews

This section summarizes KPMG's experience with statewide performance reviews over the past 17 years. Among the large auditing and consulting firms, KPMG conducted more of these types of studies at the state level than any of its competitors. Aaron Estis, the President of The ESTIS Group, participated in all of these projects and led the Kentucky and Georgia projects.

The projects reviewed in the subsections below include Washington, DC, Kentucky, Louisiana, and two statewide projects for Georgia. Each subsection includes a discussion of the project scope, the steering committee, resources used to conduct the study, standards, results, and some general comments on the effort.

Washington DC

Although Washington DC is not technically a state, its governmental responsibilities in 1989 included the responsibilities found in every state – Medicaid, aid to public education, higher education, social services, corrections, and public health to name a few. This jurisdiction-wide review occurred during 1989 and 1990 prior to the original GPAC study.

The DC project was the first in a string of jurisdiction-wide reviews that KPMG and later KPMG Consulting carried out during the 1990s and into 2000. The most significant ones were at the state level, but similar though smaller reviews were conducted at county and city levels.

Scope: The DC Commission on Budget and Financial Priorities was given the authority to review the entire budget of the District of Columbia. This included management systems as well as program areas. Despite the broad scope, the review did not include the legislative or judicial branches of government which represent only a small portion of the District's annual expenditures.

Steering committee: The DC project was led by prominent local and national figures. All of the members were private citizens. Among them were Alice Rivlin (the commission's name sake) and Robert McNamara. The commission members numbered around 25 and included several local community leaders, former district officials, and private sector executives. They were impaneled by the Mayor to provide him with recommendations on how to set the District's budget priorities.

Resources: KPMG Peat Marwick carried out the analysis using approximately 30 analysts (15 full-time equivalents) and selected specialized sub-consultants. The District did not assign any of its staff to work on the project full-time. The project team had liaisons and contacts with the District Government, but no business analysts to work on the project.

Standards: The project was conducted according to KPMG's management consultant methodology. The methodology included data gathering, analysis, and reporting using benchmarking analysis to place the District in the context of other state and local governments.

Results: The study predicted, accurately, that if action were not taken, spending would outrun revenues and deficits would mount. Hard choices were needed to avoid fiscal disaster. The study recommended cutting the size of the D.C. government workforce; investing in training, equipment and infrastructure; shifting D.C.'s pension liability to the Federal government, sharing the burden of paying for metropolitan services (such as transportation) with the suburbs, and raising more revenue, either by taxing non-resident income or increasing the Federal payment.

General Comments: Among the strengths of the approach taken in the District study was that a high profile commission oversaw it. The Commission members gave the study a level of seriousness that caused many, including Congress and the press, to take note. The immediate effect was small, but the Rivlin Commission report continues to be quoted to this day. A weakness in this approach was the lack of knowledge transfer to District managers and staff. Management of systems and programs in the District did not appear to improve significantly after the study. Five years later when the finances did not

improve, Congress imposed a control board over the city, provided it with more funds (citing among other sources the Rivlin Commission Report), and required that it balance its budget over a specified period of time.

Kentucky

In 1993, soon after North Carolina completed its statewide performance audit, the Commonwealth of Kentucky initiated a project with a similar scope but with a much different approach.

Scope: The statewide review for Kentucky included executive branch agencies but did not include higher education. The project was organized into the major management and program areas of state government – personnel management, financial management, workforce development, public safety, information technology, government operations, and human services.

Steering committee: The Kentucky project was led by the Governor’s Commission on Quality and Efficiency. The Commission members numbered around 55 and included several local community leaders, state agency officials, and private sector executives.

Resources: KPMG served as a project manager for the effort which was carried out by 42 volunteers drawn from state government agencies and from the private sector. State employees represented the bulk of the participants. Each of the seven teams on the project included at least one loaned executive. In addition the Commonwealth assigned one high-level staff person to the effort that spent close to 50 percent of his time on the project.

Standards: The volunteer staff of state employees and loaned executives received two days of training before diving into the subject matter. The participants were introduced to the structure of a performance audit finding (i.e., attribute, standard, effect, and cause) and provided background information on state government in general. KPMG’s experience in North Carolina was offered as an example of how to approach the analysis.

Results: The project produced 79 issues papers with 270 recommendations around the themes of: empowering employees, thinking and planning for results, connecting government to its customers, and investing in the future. Two years after the study, an analysis of the recommendations indicated that 33 percent had been implemented, another 44 were in progress and about \$233.8 million of the five-year savings estimate of \$905.9 million had been achieved.

General Comments: This approach was inexpensive compared with the North Carolina and Washington, DC projects. KPMG resources handled project management but the data collection and analysis was carried out by the volunteers. Consequently, the level of analysis suffered and the issue papers were not always of the highest quality. Toward the end, additional KPMG resources were applied to writing the final consolidated report which was the only document that was widely distributed. Poorly written issue papers

can make implementation difficult. On the other hand the volunteer author of the issue paper is likely to be a Commonwealth employee making it easier to get any questions about the issue paper answered. This approach is less costly, may undermine implementation, but does provide for knowledge capture by the client.

Louisiana

In 1994 and 1995 Louisiana, with encouragement from the local private sector leaders, initiated a project to address a pending gap in expenditures and revenues.

Scope: The scope of the statewide review for Louisiana included the executive branch and higher education. Teams were formed in the major management and program areas of state government – human resources, k-12, higher education, fiscal management, public safety, information technology, cash management, purchasing, economic development, and human services.

Steering committee: The Louisiana project was led by the Select Council on Revenues and Expenditures in Louisiana’s Future, which went by the acronym SECURE. A banker chaired the group, but the President of the Senate was its vice-chairman. The leadership of both the House and the Senate sat on the steering committee and were fully engaged in the process. The Committee members numbered 37 and included higher education representatives, local community leaders, legislators, and private sector executives.

Resources: The approach to staffing the Louisiana project was a hybrid of the North Carolina and Kentucky approaches. KPMG served as a project manager for the effort, led all of the teams, and even supplied many of the analytical resources. Louisiana on the other hand, wanted to use the project to train the Legislative Auditor’s staff. KPMG trained the auditors at the start of the project and included them on each of the project teams.

Standards: The volunteer staff of state employees and loaned executives received two days of training before diving into the subject matter. The participants were introduced to the structure of a performance audit finding (i.e., attribute, standard, effect, and cause) and Yellow Book standards. KPMG’s experiences in North Carolina and Kentucky were offered as examples of how to approach the analysis.

Results: The project recommended a major shift in state expenditures away from administration and lower priority programs to higher education and k-12. A review of state spending conducted by KPMG five years later indicated that just such a shift had occurred. As for other recommendations, about one-third of them had been implemented and a smaller percentage were still in progress.

General Comments: This approach was nearly as expensive as the DC and North Carolina projects, but had the added value of facilitating knowledge transfer from the consultant team to the Legislative Auditor’s staff.

Georgia I and II

Within the last six years, Georgia has undergone two statewide management reviews. One occurred in 2000 at the start of Governor Barnes' administration and the second occurred four years later when Georgia elected its first Republican governor since reconstruction. The two reviews differed in their approach, although many of the recommendations were similar. For many reasons it appears that the more recent review has been more successful than the one conducted in 2000 simply because the recommendations are being implemented.

Georgia I – Statewide Audit 2000

Scope: The 2000 study focused on finance and administrative functions in state government. The bulk of the work was performed by a KPMG consulting team with a few specialized subcontractors. The areas addressed included:

- Information technology and telecommunications
- Procurement
- Cash Management
- Risk Management
- Mail
- Fleet
- Printing
- Real estate and property management
- Minority business utilization

The State had just conducted a review of the Capitol Hill property management function so it was not included in the “statewide audit,” as it came to be known.

Steering Committee: The Statewide Audit project was led by a steering committee composed of state government officials and private sector representatives. Home Depot and IBM were represented on the panel as well as the Governor's Office the Office of Planning and Budget, the Department of Administrative Services, and the Office of Treasury and Fiscal Services. The Legislative Branch did not participate in the steering committee. Despite private sector participation, State of Georgia government officials exercised leadership over the steering committee.

Resources: KPMG Consulting supplied the staff resources for this effort. Two persons from the Office of Planning and Budget were assigned to work with the KPMG team. KPMG brought in sub-consultants to assist in specialized areas such as risk management and minority business utilization.

Standards: The RPF for this project did not specify the use of any particular standard for conducting the audit. Having conducted several of these projects, KPMG used a methodology based on what worked well in previous statewide studies. The reports in each of four areas were presented in terms of findings and recommendations. The findings were generally structured to approximate a Yellow Book audit finding.

Results: The statewide audit produced four major reports each with numerous recommendations. An informal, internal assessment of the Georgia's progress towards implementing the recommendations was carried out but not made available to the public. Here are some of the selected recommendations from the statewide audit of 2000 and their eventual fate:

1. *Create a Georgia Technology Authority:* This recommendation required an act of the General Assembly and was implemented immediately. It was at the height of the "dot com" boom. The law consolidated a great deal of power in the new organization including budgetary approvals for major technology projects, IT procurement, statewide technology standards and statewide strategic planning. It eventually housed the state's data center. The rapid consolidation of power, a poor approach to customer service, a failed mega-project (see next recommendation), the departure of the first head of the Authority, and the election of a new governor contributed to the declining relevance of the Authority. The final blow came when legislation was passed to implement a procurement transformation initiative (see procurement recommendation below) which removed IT procurement authority from the technology authority and placed it back in the Department of Administrative Services. Georgia benefited from improved coordination of technology, but the recommendation fell short of expectations because it faced significant obstacles during implementation.
2. *Privatize a converged data, voice, and video transport service:* The Georgia Technology Authority expanded this recommendation from the Statewide Audit to include several other technology related services such as desktop support and the data center. The potential seven-year contract grew to an estimated billion dollars. After some fits and starts, reissued bids, and amendments, three bidders were left – IBM, EDS, and WorldCom. Soon after the final bidders were announced WorldCom was disqualified owing to its financial problems. That left IBM and EDS. In January 2003 IBM withdrew leaving only one bidder. The state decided it could not "sole source" a \$1 billion dollar bid. By this time the enthusiasm for technology was waning and no one in state leadership had the energy or the inclination to continue the effort. This was another example of a good recommendation that suffered during implementation. Georgia was widely seen as at the cutting edge with its effort to outsource a converged data network, but implementing an expanded and ambitious version of the recommendation proved extremely difficult.
3. *Implement strategic sourcing:* The 2000 audit included a recommendation to implement e-procurement and use strategic sourcing techniques to reduce state expenditures. Georgia would have been the first state to implement such a program, but hesitated perhaps because many in the state were not convinced of the projected savings and the new State CIO (hired to head the Georgia Technology Authority) was not a fan of the recently implemented PeopleSoft system. He did not want to launch a new system that would further entrench PeopleSoft. When the new governor took office in 2004, he implemented the

strategic sourcing recommendation after a second study, which projected even larger savings than did the original 2000 study. Georgia has already purchased PeopleSoft e-procurement software and plans to implement it spring of 2007.

4. *Create a state comptroller and streamline the state's banking:* The 2000 study pointed out several major problems with the way the state managed its finances. Among them was the absence of a chief financial officer, comptroller, or its equivalent within the executive branch. The Georgia State Auditor traditionally collected all of the financial data from state agencies and component units and then audited that financial information. This arrangement presented a conflict of interest, which made the State Auditor very uncomfortable. The 2000 audit recommended the creation of a Comptroller in the executive branch and the consolidation of the 200 banks and 1,600 bank accounts through which the state managed its finances. Neither of these recommendations was carried out until after 2004 when the new governor took office.

General Comments: The Georgia Statewide Audit cost relatively more (based on scope) than the volunteer driven and volunteer assisted efforts of Kentucky and Louisiana. The recommendations were sound but often floundered during implementation. Knowledge transfer to the State of Georgia was spotty. The results of the 2000 audit were not publicized. The relative silence from the Barnes administration on the audit gave the governor the flexibility to select which recommendations he would push. There was no external body holding the governor accountable for the results. Although there were private sector members on the steering committee, they did not represent the majority of the participants and were not given leadership positions.

Georgia II -- Commission for a New Georgia 2004

Scope: As of October 2006, the Commission for a New Georgia is still active and has a broad range of activities (see <http://www.newgeorgia.org/taskforces.shtml>). Among the areas of focus are the following:

- Tourism
- Space management
- Capital construction
- Workforce development
- Community care
- Fleet management
- Procurement
- Administrative Services
- State Health Benefits Plan

Most of the task forces have completed their work.

Steering Committee: The Governor appointed a broad-based commission of private sector volunteers, two state agency heads, and retired executives to oversee the entire effort. Among the 26 members are heads of major Georgia-based Fortune 100 companies.

Resources: In contrast to the 2000 Statewide Audit, the 2004 study was carried out by a steering committee and a series of task forces both of which were composed largely of private sector representatives. Consequently, the private sector played a major leadership role in the project. Task forces were staffed on a pro-bono basis by the major consulting firms and private organizations including McKinsey, UPS, and BearingPoint. The Governor's Office hired Deloitte Consulting to staff the effort centrally. Deloitte's role was to design and stand-up a website, develop standards for the reports coming out of the task forces, prepare for steering committee meetings, and keep all of the task forces and pro-bono consultants on track.

Standards: The project did not require that its task forces follow any particular standard for carrying out the study, but did ask them to commit their findings to a standard template created by Deloitte.

Results: So far it appears that Georgia II has been more effective than Georgia I. Many of the recommendations identified in the first Georgia study were not implemented until after they were recommended in the second Georgia study (e.g., strategic sourcing and streamlined banking). The significant involvement of private sector leaders and the public nature of the second Georgia study, serve to hold the Governor accountable for implementing the recommendations. Governor's stated goal to make Georgia the best managed state has also caused him to take an interest in the study's recommendations.

A New Approach for Statewide Reviews

A review of a state government's major management systems presents a unique opportunity for the State of North Carolina to make a qualitative improvement in the delivery of services. As summarized in the section above, several states have undertaken similar studies using a variety of approaches and with varying results. The effect of the reviews can range from informational to transforming. Among the most significant factors contributing to the effectiveness of these studies is the level of commitment by state leadership.

The approach North Carolina takes to conduct its review should include the following components:

- Executive sponsorship at the highest levels of government
- Sufficient time to gather, review, and report findings
- A multi-disciplinary team with management, program, and policy expertise
- A regular and open reporting process (invite public observation, input and accountability)
- State employee participation on the project teams
- Private sector participation

Experience indicates that these factors contribute to a more cost-effective project that provides for knowledge transfer to the state government.

Key Decision Areas for the Approach

This section addresses three areas where LSO may still have some flexibility in structuring the project – project standards, the resources used to conduct the audit, and project approach. The scope and steering committee membership has been set by statute.

Project Standards

Standards can play an important role in the effectiveness of a study. They can potentially provide for better results and give a project more credibility. They can also have the effect of excluding some companies from bidding on the project¹. Today there are only four large CPA firms – KPMG, Deloitte, Ernst & Young, and Price Waterhouse Coopers. Among the four, two have been active in the statewide performance audit/management review market in recent years. North Carolina may want to consider standards that allow for more competition.

Resources

The use of state staff on project teams has proved an effective method for transferring knowledge from the consultant team to the state government. North Carolina would benefit from a process that enables the State to retain the knowledge generated during the

¹ For example, Yellow Book standards require a peer review process which is standard for CPA firms but not generally followed by the major consulting companies such as Bain, McKinsey, Boston Consulting Group, and Booz, Allen and Hamilton.

audit. In addition the State should consider finding a way to make use of the considerable public administration and public policy expertise within its borders. The public administration schools at UNC Chapel Hill, NC State, UNC Charlotte, and Duke could provide a ready and inexpensive supply of analysts and experts on government management and policy issues. Drawing upon these resources would have the added advantage of potentially sparking additional interest in North Carolina state government on the part of professors and students in the State.

Project Approach

Two further considerations may serve to enhance project outcomes:

- Enterprise business architecture
- Use of policy analysts

These two considerations are not generally included in statewide audit or performance review projects, but North Carolina may want to consider them as it structures the RFP.

Enterprise Business Architecture

The Federal government created a Business Reference Model (BRM) to provide for an organized, hierarchical construct for describing the day-to-day business operations of the Federal government. This model presents the business of government using a functionally driven approach. The BRM is the main viewpoint for the analysis of data, service components, and technology.

The Commonwealth of Virginia's Enterprise Business Architecture is based upon the Federal BRM. It is a collaborative endeavor across Virginia government to map state activities to a hierarchy of functions and processes rather than departments and divisions. EBA starts with a strategic framework based in the business of state government. The Commonwealth's EBA can be viewed at <http://www.vita.virginia.gov/cots/ea/modelAndArchitecture/index.cfm>. Virginia is working through the National Association of State CIOs to encourage the participation of other states in the development of enterprise business architectures. Several states have expressed an interest.

Virginia can use the statewide audit to map all executive branch function to the enterprise business architecture hierarchy. Such a mapping would facilitate accurate and meaningful comparisons among state governments that use the same mapping technique. Today this would allow for direct comparisons to Virginia (consistently ranked as one of the best managed states), but in the future other states are expected to embrace the EBA approach as well. The mapping exercise would yield additional significant benefits to the state such as:

- Information for improved process modeling and process re-engineering
- Documentation for automating processes in the future
- Ability to identify redundancies and opportunities for consolidation

A concentrated effort by a team of consultants during the performance audit would be sufficient to produce an EBA for North Carolina. It would also provide a basis for benchmarking findings and recommendations arising from the performance audit and would give the Legislature comprehensive picture of executive branch operations.

Policy Analysts

The qualifications of the personnel assigned to review North Carolina government's executive branch operations are critical for the success of the project. Consultants trained and experienced in public management and policy analysis will be effective in identifying and defending findings and developing recommendations that work. The RFP should require consultants with state government experience and with skills for analyzing government operations. Consistent, high quality work can be produced if the analysts assigned to the project have the right skills and experience.

Traditional management consulting skills and experience may not be sufficient for an effective review of state government programs. Analysis of administrative areas such as finance, technology, purchasing, space management, human resources, etc, is well within the purview of any traditional management consulting firm. However, even those areas are often affected by issues that are uniquely government, such as open records laws and civil service. Consultants with governmental experience may understand these issues, but many other consultants may not.

Analysis of program areas requires a different set of skills from that of a performance auditor or a typical management consultant. Because government programs often have vague and unclear goals, no financial incentives, and various and competing stakeholders they often defy straightforward analysis of efficiency and effectiveness. They more often involve an evaluation of trade-offs among stakeholders groups, between efficiency and effectiveness, and between what is possible and what is ideal. This sort of analysis is taught in the public policy and public administration schools around the country and would be valuable for North Carolina's performance audit. An approach to the performance audit that invites bids from companies that employ policy analysts would be beneficial to the state.