



September 12, 2011

The Honourable Tony Clement, P.C., M.P.
President of Treasury Board
Office of the President of the Treasury Board
140 O'Connor Street, 9th Floor
Ottawa ON K1A 0R5

Re: Input for the Strategic and Operating Review

Dear Mr. Clement:

Thank you for your invitation to submit our ideas on savings proposals in support of the Strategic and Operational Review that your department is undertaking. This reply will clarify PBO's role in the Strategic and Operating Review relative to our legislative mandate. It will provide a short history on recent spending review exercises in Canada and the UK, and it will provide an example of the best-practices assessment framework for these types of initiatives.

Role of the PBO in the Strategic and Operating Review

The PBO mandate requires that my office provide independent fiscal/financial analysis to Parliament and estimate the financial cost of any proposal that relates to a matter over which Parliament has jurisdiction. Your request for ideas on savings proposals however is beyond the legislative mandate of the PBO. Should Parliament ask, the PBO is prepared to examine any aspects of the Strategic and Operating Review contained in the Estimates based on their risk and materiality.

We have provided below a general framework with which the PBO would assess departmental savings. We have also provided some examples from Canada and the UK on best practices and lessons learned from these types of operational efficiency initiatives.

A Short History on Operating Reviews

Operating efficiencies within governments are difficult to achieve, and the Canadian experience has been uneven. Canada undertook an Expenditure Review exercise in 2004, whose savings targets were announced in Budget 2005. In November of 2006, the government recognized that savings from one of the initiatives was significantly overstated and a subsequent adjustment was made to the fiscal framework to account for the shortfall.^{1,2} A significant portion of the shortfall was attributable to a procurement reform initiative whose savings projections were overstated. There were several significant risks to this initiative:

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¹ <http://www.fin.gc.ca/ec2006/pdf/ec2006e.pdf>, p. 36, accessed August 11 2011.

² <http://www.budget.gc.ca/2007/pdf/bp2007e.pdf>, p. 285, accessed August 11 2011.

- *Strategy Risk*: the initiative called for a centralized, monopolistic service delivery model that was inconsistent with comparable projects in other jurisdictions, which favoured a contestable markets strategy
- *Process Risk*: the initiative lacked a performance measurement framework and a validated baseline cost against which to measure potential future savings
- *Infrastructure Risk*: there was no causal linkage between the technology applications and their putative benefits, and there was limited evaluation of alternative tools or vendors offering competing applications.

The United Kingdom's experience also provides a useful reference point. In its audit of the most recent Comprehensive Spending Review (CSR) program ending in 2010, the UK National Audit Office (NAO) found that of the reported GBP 2.8 billion in savings to that point, only 38% of that amount fairly represented sustainable savings.³ The NAO also concluded that it was unlikely that the CSR savings objective of GBP 35 billion would be achieved.⁴

Assessment Framework

Fiscal Merit

Many proposals that seek operational savings involve an upfront investment, either in acquiring expertise or specialized infrastructure, or to fund severance packages for workforce adjustment, as well as a purported stream of savings that should exceed the value of the investment over a specific time horizon. PBO would undertake a test of reasonableness for any savings proposal. This would involve risk-adjusted calculation of the Net Present Value (NPV) of the proposed savings and investment over the projected time horizon of the proposal, using a range of discount rates. This sort of assessment would provide a common basis of comparison among projects.

Implementation Risk

As you indicate in your letter, the Strategic and Operating Review seeks to find permanent ongoing savings in departmental operations. This requires going beyond short-term efficiencies into potentially major transformations of government operations. As budget officers, PBO is most concerned with determining the risk of achieving the full value of efficiency savings proposed. Because the government intends to book these savings in the fiscal framework, any variation from the proposed savings target could have an impact on the government's fiscal balance.

The organizational risk analysis framework described below is used to classify and describe the best organizational practices. The premise of this framework is to recognize the importance, interdependence and need for alignment amongst the discrete elements.⁵

Strategy Risk: Does the overall strategic approach appear to be sound? Is it consistent with best practices in the private and public sectors?

In general, the primary objective of most public sector operating reviews is to improve public sector labour productivity that is, seeking to maintain or enhance the quality of public services at a lower ongoing cost.

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³ UK National Audit Office, HM Treasury - Progress with VFM savings and lessons for cost reduction programmes, July 2010, p. 5.

⁴ Ibid. p.6.

⁵ A high-level version of the analytical framework originates from Deloitte Consulting, LLC (Reorganization Services Group, New York NY).

In your guidance to departments, you have asked that organizations focus on achieving efficiencies from their operations as well as to rethink business processes and service delivery platforms.

Based on materiality and risk considerations, PBO would analyze the business case of the proposed initiative to understand the strategic approach being taken to improve public sector labour productivity, and we would assess this approach against comparable public and private sector initiatives. Two examples of a strategic approach would be 1) the establishment of a centralized common service provider and 2) the transfer of a departmental business process to a third-party supplier.

Human Resource Risk: Does the proponent of the savings initiative possess the capabilities to successfully implement the initiative? How does the proponent's human resource capability compare with that found in comparable projects or initiatives in the public and private sector?

PBO would seek to understand the track record of the management team responsible for implementing the savings initiative, and compare the nature and quality of the team's experience against teams of comparable projects in other jurisdictions.

Process Risk: Does the proposal require the re-engineering of existing business processes? What is the magnitude of the proposed changes and how easily can they be implemented? What is the effect on stakeholders?

PBO would review the baseline business process maps (as-is) and compare them to the projected future business process (to-be) in order to understand the nature of the proposed savings. The UK NAO has noted that 'often departments do not have a good grip on the costs of their activities, and it is rare to see good information on the unit costs of outputs'.⁶ This information is critical as it allows a discussion around what processes to stop, what to change and what to continue.

Infrastructure Risk: Is the existing infrastructure (e.g. information technology, capital assets, and governance and underlying legislation) adequate to execute the proposal, or is new infrastructure required (or new legislation/governance model). Are there risks inherent in the use/purchase of new infrastructure?

Most successful projects develop technology platforms to support the future business process. PBO would assess the business case to determine to what extent the strategic approach might be influenced by the choice of technology tools.

To conclude, successful savings initiatives accurately define the current state of the business or process under consideration, clearly identify the end state of the modified or transformed business operation; include a benefits realization plan to extract the purported savings and a performance measurement framework to measure and report on the results. The proposals must also generate a sufficient risk adjusted financial return in order to merit consideration in a fiscal (rather than policy) context. As mentioned above, these are not short-term turnarounds seeking immediate efficiencies but rather involve long-term fundamental transformations that are inherently more difficult to implement.

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⁶ UK National Audit Office, A Short Guide to Structured Cost Reduction, 2010, p. 4.

We thank you for your invitation to submit our ideas, and we remain available to assist you in your capacity as a parliamentarian. Please do not hesitate to contact my office at 613-992-8026 if you have any further questions or require clarification.

Yours truly,


 Kevin Page
Parliamentary Budget Officer

c.c.: William R. Young, Parliamentary Librarian, Library of Parliament