



# Washington State Shared Services Model

October 15, 2009





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## Executive Summary

On February 10, 2009, Governor Gregoire issued Governor's Directive 09-02, directing state agencies to provide full assistance and support in the development and implementation of a shared services model. The Governor stated that, "Sharing administrative functions between agencies will allow you to focus on your core missions of providing essential services to Washingtonians. I expect that our new shared services approach and governance structure will capture the benefits of economies of scale in a way that ensures good customer service to the client agencies."

In response to the Governor's Directive, this paper recommends:

- A shared services model for the state of Washington
- A governance structure to implement and operate Information Technology shared services. This could be considered for other business areas.
- Key principles considered essential to successful implementation and operation
- The decisions and next steps needed to establish the shared services model and begin implementing shared services

For Washington state government, a shared service is defined as:

The concentration of state and other related resources performing like-activities, currently spread across the organization, to service multiple partners at lower cost and with higher service levels. The purpose is to optimize the value of IT and business services to front office and back office staff resulting in improved service to the people of Washington.

Four characteristics that distinguish a shared service are:

- Collaborative service development
- Partner participation in governance
- Focus on continuous service improvement
- Organizational position based on what makes sense for cost effective, high-quality delivery

The primary purpose for shared services is to reduce duplication of effort, enable staff to focus on the highest-value work of the agency, and provide more services with the limited resources available. Job enrichment, career opportunities, re-training and other personnel issues will be addressed in the early stages of each shared service.

An up-front investment will be required for startup and transition of some shared services. Shared services will provide transparent service levels and prices that are negotiated in ways that make sense for all participants.

This shared services model was developed through a collaborative effort with a large group of agency Chief Information Officers (CIOs), the Director of the Department of Information Services (DIS), and the Washington Federation of State Employees. The model employs practices proven over the last 10 years by leading organizations that successfully deployed shared services. Taken together the collaborative effort and industry experience resulted in a shared services model tailored to meet Washington's needs.

In the public and private sectors, shared services have shown dramatic savings with improvements to productivity and service quality. These are important ways to obtain more value from the state's investment in service delivery.

The recommended next steps are to:

- Obtain feedback on the shared services model from agency leaders statewide
- Recommend adoption of the resulting shared services model
- Implement the governance structure and appoint the members to the Shared Services Governing Board
- Use shared Email as a learning experience to test and improve this shared services model

*“Maximizing the value of shared services and minimizing the risks entail getting a clear view of the benefits the enterprise seeks. The design, implementation and operation of shared services are built around these benefits, taking into account the enterprise’s appetite for, and ability to accomplish, change.”*

*– Gartner*



## Background

On February 10, 2009, Governor Gregoire issued Governor’s Directive 09-02, directing state agencies to provide full assistance and support in the development and implementation of a shared services model. The Governor stated that, “Sharing administrative functions between agencies will allow you to focus on your core missions of providing essential services to Washingtonians. I expect that our new shared services approach and governance structure will capture the benefits of economies of scale in a way that ensures good customer service to the client agencies.”

In response to the Governor’s Directive, this paper recommends:

- A shared services model for the state of Washington.
- A governance structure to guide decision making to implement and operate Information Technology shared services. A similar model can be used for shared services in other business areas.
- Key principles considered essential to successful implementation and operation.
- The decisions and next steps needed to establish the shared services model and begin implementing shared services. The business case and implementation plan for each new shared service will be developed and approved on a case-by-case basis according to this shared services model and governance structure.

A critical next step is to review this paper with the community of agency leadership and incorporate key suggestions for improvement. This step will ensure that agency business needs are accounted for and will add to the success of shared services delivery.

This paper was developed through a collaborative effort with a large group of agency Chief Information Officers (CIOs), the Director of the Department of Information Services, and the Washington Federation of State Employees. Participants are listed in Appendix 1.

**For Washington state government, a shared service is defined as:**

*The concentration of state and other related resources performing like-activities, currently spread across the organization, to service multiple partners at lower cost and with higher service levels. The purpose is to optimize the value of IT and business services to front office and back office staff resulting in improved service to the people of Washington.*



## Characteristics of Shared Services

1. **Enterprise Utility Shared Services:** services and applications common to all enterprise partners, and managed by one entity for all agencies and jurisdictions to improve service and/or reduce costs.
2. **Multi-Agency Shared Services:** services and applications required by more than one enterprise partner, and managed by one entity to improve service and efficiency.

There are at least four characteristics that distinguish shared services:

*Notice that in our definition the word concentration was used rather than centralization or consolidation of resources.*

- **Collaborative service development:** Agency business units are seen as partners with the shared service provider. As the partners concentrate their like-activities with the provider, they play a major role in defining shared service levels and expectations, prices, quality standards, performance measures, and the roles and responsibilities of the provider and consumers. These are included in the business case and service level agreement for each shared service. There is joint accountability for costs and quality through service level agreements.
- **Partner participation in governance:** A governance structure, that includes partner input, guides decision making on service levels, scope, pricing, service delivery, performance management, operations, and continuous improvement.
- **Focus on continuous service improvement:** There are ongoing efforts to improve service, reduce cost, or both. The benefits should accrue not only to the agencies but to Washingtonians as well.
- **Location of the service provider:** Service providers can be concentrated into a single location, centers of excellence, or embedded into each business unit in a physical sense, although they all report to the shared service provider's management, rather than to an individual agency's management. The service provider's organizational placement and physical location are driven by the optimization of the cost and the service level. The provider must possess the capacity, readiness, and executive support to serve.



## Key Design Principles for Shared Services

The following principles will shape the design of each shared service:

1. Shared services will concentrate like activities that are viewed as “support” and secondary to core processes, and treat them in the provider organization as core processes themselves. This frees up scarce resources in agencies to focus on their core mission. In turn, the shared service activities and staff receive high levels of support and management attention in the provider organization.
2. The business case for each shared service must show how the intended benefits accrue to each consumer, the provider, and to the state as a whole.
3. The primary purpose of shared services is to improve service to citizens and line staff in core business functions at a lower cost, helping the state to satisfy unmet needs with current staff levels and lower budgets.
4. Each shared services assessment should identify job enrichment and career opportunities for staff.
5. Incentives for providers and consumers will be negotiated and built into each shared service. Providers need essential start-up funding, resources, and support. For consumers, the shared service must cost less, provide better service, or both. Enterprise utility shared services must offer a clear statewide benefit; losses to individual agencies should be mitigated.
6. Shared service assessments and designs will provide transparent service levels and rates. Tiered services and pricing should be negotiated, starting with a base level service that all consumers need at an attractive price. Additional tiers and prices should build up from there.
7. For enterprise utility shared services, the assessment team will identify the agency adoption rate needed to produce targeted service improvements and benefits. Agencies are invited to opt in. The Shared Services Governing Board, however, will make the final decision on the timing and rate of agency adoption necessary to ensure

the state receives the expected benefits. For smaller multi-agency shared services, the participating agencies will opt in and operate the service through interagency agreements or service level agreements.

8. Benchmarking and performance measurement are essential ingredients to each shared service. Benchmarks help to articulate the expected business value for each shared service and provide initial targets for performance, benefits and service improvement. Ongoing performance analysis will occur to determine whether benefits are being achieved and how additional cost savings and service improvements can be made.
9. Each shared services implementation must manage the numerous changes from the as-is condition to the new service approach, and incorporate staff input on the approach.
10. Regular communications must keep staff and stakeholders informed at each step.
11. Agencies will depend on shared services and providers to accomplish their mission. Providers will be supported accordingly and services will be appropriately resilient.

The success of shared services depends on additional components such as effective governance, care for our personnel, financial considerations, and others discussed in subsequent sections of this paper.

Existing state services that are very similar to shared services include:

- Enterprise Business Portal
- Master Licensing Service at the Department of Licensing
- Enterprise Active Directory
- Ortho Image Portal
- Human Resource Management System

In each of these cases, a service provider was identified, and the provider and partners agreed on the service, features, and prices. These were documented in an agreement. In most cases, a governance model was established to design and operate the service.

*“Centralization is often confused with shared services. By understanding the similarities and differences between these constructs, IT leaders can ensure that service delivery capabilities meet business expectations.”*

– Gartner



## Expected Business Outcomes of Shared Services

Shared services produce one or more of the following business outcomes:

- Drive cost and effort out of line and support services, including IT services
- Add value to line and support services
- Line staff will have better information and tools to do their job
- Leverage existing agency resources, data, and processes. Avoid duplication.
- Reduce risk
- Reduce time to market
- Reduce time for problem resolution

### ***How to Recognize an Opportunity for a Shared Service***

- *Standardization is possible*
- *Resources are underutilized*
- *Economies of scale are possible*
- *If an agency has data, a facility, an application, or a process that other agencies need or currently duplicate, it could be a candidate for a shared service.*



## Governance

A strong and effective governance structure is essential to the success of shared services implementation and operations. The governance structure ensures that:

- Critical business decisions are made in a timely manner
- Services are deployed in ways that produce planned results
- The needs of consumer, provider agencies, and other stakeholders are satisfied by each service

The governance structure recommended for Washington is similar to those found in most public and private sector organizations. It consists of three tiers: one overall Governing Board, and an Advisory Committee and a User committee for each shared service.

### Governing Board

The Governing Board provides the strategy, funding, and leadership to approve shared services and ensure they are implemented in ways that achieve targeted benefits. Key responsibilities of the Governing Board include:

- Provide the necessary leadership to ensure implementation of shared services
- Approve a recommended shared services strategy
- Exercise authority to make decisions, resolve issues and remove barriers
- Approve requests for start-up funding from a pool, if appropriated
- Decide on levels of adoption for enterprise utility shared services
- Prioritize future shared services
- Commission and approve assessments for enterprise utility shared services

Membership for the Governing Board consists of the Governor's representative, OFM, an elected official, two consumer agency directors, and the DIS Director.

A designee of the Governing Board will seek input from the bargaining representatives of the affected state employees before key Governing Board decisions are made. The input should

include whether the bargaining units support or oppose the recommended decision, and the rationale for that position. The designee will inform the bargaining unit representatives of decisions reached by the Board in a timely fashion.

## Advisory Committees

There will be an Advisory Committee for each shared service. This committee is created when an assessment is approved by the Governing Board. It contains representatives from the provider and consumer agencies. It oversees the collaborative process to design, implement and operate a given shared service. Key responsibilities of this committee are to:

- Preserve an optimal balance between service level and cost
- Approve Service Level Agreements, tiers of service and pricing, quality standards, performance measures, and the roles and responsibilities of the provider and consumers
- Improve service while holding costs constant, or lower cost without diminishing the level of service
- Ensure that the business case is satisfied in the shared service's design
- Resolve issues or escalate them to the Governing Board
- Approve measures for continuous improvement in service delivery, cost, or both based on performance measures
- Provide guidance on processes, policies, standards and procedures
- Provide oversight of implementation and go-live
- Work with the User Committee to improve and expand the service
- Report on annual savings and service improvements achieved

The membership of this committee will consist of managers from both provider and consumer organizations, and the exclusive bargaining representative for affected state employees. The Advisory Committee should be supported by an individual experienced in the design and implementation of major shared services, preferably in the public sector.



## User Committee

The User Committee provides consumer input to guide the operation and continuous improvement of a given shared service. This committee ensures that the collaborative nature of shared service delivery is maintained during all aspects of the shared service life cycle. Members of this committee:

- Provide feedback on the operation of the service
- Serve as process champions in the consumer organizations
- Collect first-hand feedback from their peers and channel it back to the provider
- Make suggestions for continuous improvement
- Oversee performance measurement and reporting
- Develop a plan for branding and promotion of the service

Membership in this committee includes unit managers and employees from the provider and consumer agencies, and the exclusive bargaining representative for affected state employees. The committee should consider members from potential consumers to help ensure as broad a view of the service as possible.

Updates to the governance structure and the overall shared services model in this paper will be approved by the Governing Board.

*“Good governance in a sharedservice context balances strong internal customer input with strong senior sponsorship. Formal mechanisms must be complemented by informal behaviors...”*

– Gartner



## Personnel Considerations

There is a large unmet demand for IT solutions and government services to Washingtonians. Shared services can be a key strategy to gain greater efficiencies by providing more solutions and services with the limited resources available and enabling staff to focus on the work of highest-value to the state.

Employees are our most valuable resource in providing solutions and services. Shared services should reduce duplication of effort and non-staff costs, allowing reinvestment in other areas.

Delivering services in a new way will mean changes for employees. As we consider ideas for service changes we must consider what employees will need to be successful in those changes and commit to supplying what they will need to achieve that success. These include:

- Provide employees a good explanation of the problem the state is trying to address or the opportunity it wants to achieve.
- Give employees an opportunity to have a role in the change to new service delivery approaches.
- Communicate thoroughly and constantly with employees.
- Understand that any change, even good change, means that staff will experience a loss of the old ways along with the benefits of the new. We need to work with employees to acknowledge, commemorate and compensate for those losses.
- Provide training and other career development services necessary to enable employees to be successful in new roles.
- Consider carefully the design and definition of new roles to maintain job richness and viable career paths.
- Fulfill all legally mandated collective bargaining obligations.



## Financial Considerations

The following financial considerations will be addressed in the assessment and design of shared services. As our state enters the next stage of its shared services initiative, details in these considerations will be added to shape development.

### Cost Analysis

- A consistent, transparent cost model is needed to evaluate costs of a proposed service at agency and statewide levels, including startup, transition and operations costs.
- If an up-front investment is required to implement a shared service the analysis should calculate the payback period and the return on investment over an appropriate time horizon (often longer than one biennium).
- Consumer agency sunk costs, such as existing software licenses and equipment must be considered and addressed in some way in the transition to a shared service.

### Pricing

- Shared services must be priced in a way that:
  - Meets key consumer criteria (e.g. transparency, controllability, fairness, etc.)
  - Provides financial stability, manageability, and capacity for continuous improvement
  - Meets federal and state audit requirements
- Tiered pricing should be based on service levels and features consumers need and are cost effective to provide.

### Strategies for financing the start-up and operating costs for shared services

- Funding sources (for both providers and consumers) will be identified for each shared service. The source and amount will vary based on the scope and nature of the service.

Appendix 4 offers a fuller treatment of these and other financial considerations. They are grouped under three questions:

- Does the proposed shared service make financial sense?
- What do shared service providers need to finance a shared service offering?
- What do shared service consumers need to purchase a shared service offering?

Please refer to Appendix 4.



## Shared Services Examples

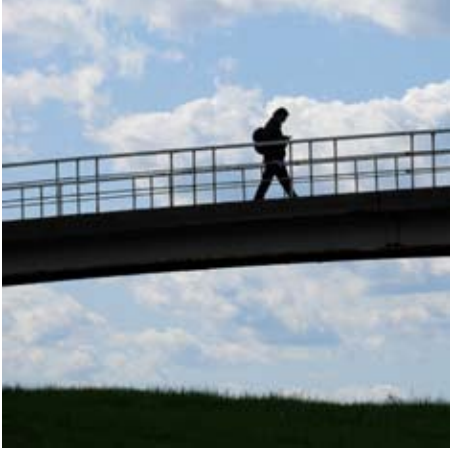
Two shared services examples were used in the CIO Work Group to surface the essential questions for the assessment outline in Appendix 2:

- Shared Vital Records (provided by DOH, consumed by DSHS and DOL).
- Shared Email.

These shared services have been proposed at agency or statewide levels. There has been no decision to implement either service.

A small group is forming regarding shared email as of this writing to:

- Identify the features of the current email service used by some agencies
- Apply the shared email example to test and improve the assessment outline



## Phases of Shared Service Development

Each shared service will undergo a series of phases leading to deployment and operation. Some of these will be performed sequentially and others will be performed iteratively. Change management and communication will guide each phase. Implementation will comply with applicable state policies and standards.

Phases	Description	Parties Involved
Identification	<ul style="list-style-type: none"> <li>An agency, the Customer Advisory Board, a consortium of managers, or staff may suggest a shared service</li> <li>The Governing Board receives and prioritizes these suggestions</li> </ul>	Governing Board
Assessment	<p>Each proposed shared service is assessed using the outline in Appendix 2, including:</p> <ul style="list-style-type: none"> <li>The strategic direction and vision</li> <li>Identify executive sponsor</li> <li>Business case</li> <li>Re-engineering business processes</li> <li>Operating model</li> <li>Breadth of deployment</li> <li>Costs of implementation</li> <li>Organizational and staff impacts</li> <li>Enterprise architecture and service-oriented architecture opportunities</li> <li>Risk</li> <li>Go No-Go decision (by Governing Board for enterprise utility services)</li> </ul>	Governing Board, Sponsor, Assessment Team (prospective provider and consumers of the service)

Design	<p>The design of the shared service includes:</p> <ul style="list-style-type: none"> <li>• Creation of Advisory Committee</li> <li>• Balance service level and cost</li> <li>• Organizational placement of provider</li> <li>• Re-engineer business processes</li> <li>• Transparent service levels and pricing</li> <li>• Chargeback methods</li> <li>• Functional characteristics</li> <li>• Resource requirements</li> <li>• Validation of scope and funding requirements</li> <li>• Staff impacts and accommodations</li> <li>• Change management and control</li> <li>• Implementation plan</li> <li>• Schedule</li> <li>• Go No-Go decision (by Governing Board for enterprise utility services)</li> </ul>	<p>Governing Board, Sponsor, Advisory Committee (provider and consumers) Design Team, Central support organizations as needed</p>
Build	<ul style="list-style-type: none"> <li>• Develop/enhance necessary functions</li> <li>• Integrate support functions such as billing, customer support and service level tracking</li> <li>• Manage budget and schedule</li> <li>• Add service description and access information to the state’s “shared services catalog”—a reference tool for consumers seeking services</li> <li>• Go No-Go deployment decision (by Governing Board for enterprise utility services)</li> </ul>	<p>Governing Board, Advisory Committee, Sponsor, provider and consumer organization representatives, build team</p>
Operate	<ul style="list-style-type: none"> <li>• Create User Committee</li> <li>• Monitor performance against service level agreements</li> <li>• Review and adjust progress against budget</li> <li>• Review and adjust staff support</li> <li>• Develop service upgrade path</li> <li>• Add additional consumers</li> </ul>	<p>Governing Board, Advisory Committee, User Committee, Sponsor, provider and consumer organization representatives</p>

Shared services of all sizes and types should follow this type of process to avoid classic mistakes and accrue the potential advantages of funding opportunities, broader organizational support and visibility.

**Notes about the Identification and Assessment phases:**

- When a new shared service opportunity is identified, the prospective provider and consumers will form an assessment team. Teams can be self-formed, or one can be commissioned by the Governing Board.
- Assessment teams will use the outline in Appendix 2 to complete the assessment phase of proposed shared services. The assessment outline identifies the issues to address to develop a complete service, facilitate approval, implement it effectively, and attain the expected benefits. The assessment is meant to ensure the successful implementation and sustainability of the proposed shared service, not to act as a barrier to letting good things happen. The Board may opt to have some threshold criteria which would enable or encourage small, optional low-risk ideas to move forward with an “assessment-lite.”

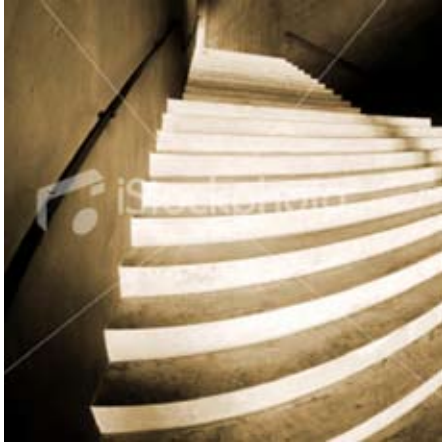
The assessment outline will foster consistent and complete designs and evaluations of proposed shared services prior to approval for implementation.



## Critical Success Factors

The following factors must be in place to successfully implement shared services in Washington:

1. The governance structure is formally adopted and implemented.
2. The Shared Services Governing Board is formed, and is:
  - a. Reviewing and approving recommended strategies and priorities for enterprise utility shared services
  - b. Making business decisions on enterprise utility shared service assessments, business cases, and adoption rates
  - c. Fostering state level commitment to implement shared services
  - d. Removing barriers and providing support to providers and consumers
3. An experienced shared services leader is retained. This expertise is essential to design and implement shared services in ways that achieve targeted benefits and facilitate successful transition.
4. A sufficient level of experienced support is available to managers and staff who lack fundamental capacity and skills to manage the change to shared services. Effective change management is essential to care for our staff and guide the intended changes.
5. Project management support must be available to guide successful implementation.
6. Startup funding is available as approved in each shared service assessment. This enables development by the provider and transition to the new service for consumers.



## Next Steps

Recommended next steps to begin implementing the shared services initiative:

- Confirm the proposed definition of shared services for Washington
- Agree to or update the business outcomes, principles, and statements of this paper
- Retain an experienced statewide shared services leader
- Form the committees in the governance structure
- Use shared Email and Vital Records Sharing as learning experiences to test and improve this shared services model and governance structure.
- Finalize the shared services assessment outline and a financial consideration template
- Finalize and execute an overall shared services communication plan. This includes descriptive materials on shared services, and could include a shared services summit that includes business and technology leaders and staff from across the state.

### ***Related Initiatives***

*State Auditor's benchmarking analysis on IT services*

*Shared services initiatives in the Department of Personnel and General Administration*

## Concluding Remarks

Given the state of the economy and forces for change already in place, the alternative to shared services experienced in other states has been far more disruptive. The shared services initiative directed by the Governor offers the means to avoid these more difficult measures.





## Appendix 1

Participating Chief Information Officers (CIOs) and Attendees  
In the Shared Services Initiative

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Sherri-Ann Burke	WFSE
Kit Bail	DOC
Mike McVicker	ESD
Phil Grigg	GA
Vikki Smith	DOR
Christy Ridout	LNI
Rob St. John	DSHS
Grant Rodeheaver	DOT
Jeff Kiper	DVA
Steve Young	DOP
Andy Hill	ATG
Lynne McGuire	OFM
Frank Westrum	DOH
Dan Parsons	WSP
Gary Wilkinson	Commerce
Carl Harris	AGR
Dan Russ	MIL
Terry Rudeen	LOT
Melissa Rohwedder	DIS
Debbie Stewart	ECY
Bill Teed	SEC
Mike Huntley	SEC



## Appendix 2

### Assessment Outline for Proposed Shared Services

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The purpose of this assessment is to foster consistent and complete evaluations of proposed shared services prior to approval for implementation. By properly addressing the subjects below a proposed shared service is much more likely to be implemented successfully and produce the intended results.

Depending on the scope and scale of the service being considered, a subset of these subjects could be addressed or the depth of treatment could vary based on direction from the Shared Services Governing Committee.

1. Purpose and support for the proposed shared service
  - a. Executive sponsor
2. Current Process or Service – As-Is baseline analysis
  - a. Description of like-services currently performed, including organization(s) and location(s)
  - b. Problem to be solved or opportunities to gain in current situation
3. Proposed Shared Service – To-Be Description
  - a. Description and location(s) of shared service including feature set(s), or options
  - b. Proposed provider and consumers (partners)
  - c. Service levels – beginning with the base level all consumers need
  - d. Roles for the provider and consumers, including the point of demarcation
  - e. Alternatives considered
  - f. Proposed business process changes
4. Business Case
  - a. Cost/Benefit analysis
    - i. Statewide level
    - ii. Agency level
  - b. Targeted savings, service quality improvement, other impacts
  - c. Business opportunities provided
  - d. Incentives for the provider and consumers
  - e. Description of how benefits will be realized by consumers and the provider
  - f. Risk assessment
5. Overview of the Implementation Plan
  - a. Transition approach, teams, costs, technology, facilities, other resources, schedule, risks/mitigations
  - b. Barriers and plans to overcome

6. Change Management Plan
  - a. Describe the changes to make and how they will be successfully managed
    - i. Organizational, personal, technical, financial, process, etc.
  - b. Describe the change control process and changes to address
7. Communications Plan
  - a. Determine who must receive what information, and when
8. Organization
  - a. Identify the provider and all consumers
  - b. Roles and Responsibilities of all parties
  - c. Organizational placement and structure for the service
9. Governance
  - a. Ties to statewide governance models
  - b. Governance specific to the shared service
10. Related initiatives
11. Human resource considerations
  - a. Change to current job mix and assignments
    - i. Current staff levels supporting service
      1. Full time/Part time
      2. Organizational alignment
    - ii. Expected staff level supporting operation
      1. Full time/Part time
      2. Organization alignment
    - iii. Staff transition to new shared service
  - b. Support for staff
    - i. Training/Retraining plan and budget
    - ii. Job enrichment
    - iii. Incentives
  - c. Potential positions or similar opportunities with the shared service provider
  - d. Other job classifications staff are eligible to fill
    - i.
  - e. Required skill sets
    - i. Implementation
      1. Skills
      2. Workload
    - ii. Operation
      1. Skills
      2. Workload

12. Financing
  - a. Cost model
  - b. Pricing model(s)
  - c. Funding sources
    - i. Implementation
    - ii. Operations
  - d. Total Return on Investment
13. Technology
  - a. Current technology and architecture, including where it is deployed
  - b. Proposed technology and architecture
  - c. Need for re-engineering
  - d. Availability requirements – are there maintenance windows or other outages planned by the provider agency that will impact consumer agencies.
  - e. Disaster Recovery (DR) and Continuity of Operations (COOP) requirements - The system may support different levels of criticality and therefore different DR and COOP requirements for different agencies.
14. Facilities
15. Culture
  - a. Cross-organization teams
  - b. Current and future span of control
  - c. Staff transition perceptions on the shared service
16. Controls
  - a. Service Levels
  - b. Regulatory requirements
  - c. Management structure
17. Performance Measurement



## Appendix 3

### Essential Enablers for Shared Services

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This list of enablers was collected from the CIOs during team work sessions. Participants raised these topics to address, now or in the future, to successfully develop and implement shared services.

#### Enterprise considerations

- Ownership by business leaders in the provider and consumer organizations
- Business sponsorship – Business divisions must see value in a proposed shared service
- Build business acceptance and trust
- Enterprise Architecture
- Governance
- One agency cannot do it all
- “Do no harm”
- Flexibility in IT and business
- Identify the drivers behind each possible shared service

#### Tools and conditions that facilitate creation and operation of shared services

- Provide common support for multiple shared services
- Liability protections
- Standards for shared services
- Develop or obtain expertise to design, implement and operate shared services
- Catalog of operating shared services
- Pricing and options must be clearly spelled out
- A shared service must be institutionalized in the host agency so that the service is reliable and available to the degree needed
- Negotiated services (by the provider and consumers)
- Centers of excellence
- Sufficient capacity to provide the service

## People

- Strategy to incent staff (what's in it for them??)
- Management and staff need the skills and a process to create and operate shared services
- Need to overcome the “emotional importance” of the status quo for some staff

## Funding

- Common budget and pricing mechanism
- Chargeback system for shared services
- Recognize costs of implementation – business support necessary
- Seed money for new shared services
- Dedicated capital budget for IT
- Access to a revolving fund



## Appendix 4

### Financial Considerations for shared services

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## Introduction

This report groups financial considerations into three areas

This section will discuss the financial considerations and mechanics necessary for shared services and will make recommendations on removing real or perceived barriers. This report groups shared services financial considerations into three areas:

- Does the proposed shared service make financial sense?
- What do shared service providers need to finance a shared service offering?
- What do shared service consumers need to purchase a shared service offering?

This section will try to note when the basic financial considerations would differ depending on the scale of the shared service offering. (e.g. required-use enterprise utility service, optional multi-agency service)

## Does the proposed shared service make financial sense?

There are several ways of looking at costs

Does the proposed shared service make financial sense? Is this the best cost alternative? The answer to these questions may vary depending on the perspective of the one asking the question. It's important to note that there are several ways in which a shared service cost/price will be compared to alternatives.

1. The total cost to government compared to an alternative approach
2. The cost for a shared service provider to provide it versus the cost for an agency to do itself.
3. Cost for the service in the private sector marketplace

1. What is the total cost to the state compared to an alternative?

When an enterprise utility shared service is proposed for full statewide use, decision-makers and agencies will want to know whether this is the lowest total cost alternative to the state. While ideally this cost analysis would be one part of a full cost/benefit analysis, the shared service proposer should expect that the cost analysis will receive special scrutiny.

**An apples to apples comparison**

Decision-makers will need fair and comparable cost estimates for the proposed shared service, the status quo and any other alternatives being considered. It can be difficult to develop a perfect apples-to-apples comparison. For example, agencies currently performing the activity will likely have sunk costs in infrastructure and staff training while a new shared service provider may have significant start-up costs. Data collection and verification from agencies may require a substantial effort.

**Key components**

Yet it is possible to produce a reasonable, fair and comparable cost analysis. Some key steps include:

- Clearly defining the scope and character of the proposed shared service.
- Clearly defining assumptions and caveats. Capturing data about current costs across state government may be difficult. Assumptions will most likely have to be made, but these should be vetted with agencies to ensure the most reasonable assumptions are made.
- Understanding current service level volumes and clearly defining desired service level volumes for the analysis.
- Defining cost components of providing the service clearly to ensure the costs are treated comparably in each alternative. For example:
  - Direct costs - the costs of labor, goods, and services clearly and directly involved in the provision of the service.
  - Indirect costs- These costs must be incurred in order to provide the service but are not feasible or affordable to track them directly. Usually cost allocation, using some logical surrogate for the cost driver, is used to assign a portion of these kinds of costs to the service. (Examples include utilities, personnel services, etc.)

- Overhead costs- These “for the good of the order” costs of an organization do not typically vary based on the size or volume of the business. (For example, the director’s office cost). These are not always included in the calculation of a service’s total cost; if so some allocation method is required.
- Fixed vs. Variable costs – Determine whether it is useful to further break down the indirect and overhead costs into fixed and variable components.
- Clearly identifying the one-time start up costs for the would-be service provider, including:
  - Design and planning costs
  - Implementation costs (e.g. infrastructure, equipment, installation, initial training)
- Acknowledging the sunk costs for current providers and determining the disposition of these assets and this affect on the analysis.
- Selecting the appropriate time period for the cost analysis to ensure that start-up costs can be recovered over a reasonable period of time and providing an adequate picture of the life-cycle costs of the service delivery options.

**The State Auditor’s Office is reviewing information technology cost and price models**

The State Auditor’s Office is conducting an Information Services Cost Study this fall. Included in this review is an analysis of the total costs of a selected set of IT services in five agencies. The study will also compare the total cost of ownership to other organizations and prepare a standard pricing model. The outcomes of this effort may provide helpful guidance to a standard approach for analyzing the total cost to state government of service delivery alternatives.

**Identify benefits and when they can be realized**

The analysis of the proposed mandated shared service should also consider, and if possible quantify, the benefits offered by each alternative. For example, a shared service may offer reduced risks or higher service levels. The discussion of benefits should include a timeframe in which consumers or the state should expect to reap those benefits.

If cost savings are expected, the proposer should indicate how actual savings could be identified and tracked as the service is implemented.

**Estimate the payback period and the ROI**

If an up-front investment is required to implement a shared service the analysis should calculate the payback period and the return on investment over an appropriate time horizon. (If the investment is significant, the time horizon will likely be longer than one biennium.)

**2. Can the shared service provider provide it for less than the cost for an agency to do it itself?**

A shared service offering may prove to provide the lowest total cost to the state, but certain agencies may end up paying more than they do currently, while others may experience significant savings. If a shared service makes financial sense for the state as a whole, why won't it provide a better deal for each agency? There are several reasons why this might happen:

- An agency might be at a very high level of maturity and cost efficiency in a certain service area. The new shared service provider may not be able to match this service level. While its service price is a great deal for most agencies, it's more than the current cost for this particular high-performing agency.
- By moving to the shared service, a consumer agency will eliminate its direct and variable indirect costs related to providing a service. If the shared service price is more than the eliminated costs, however, the consumer agency will face more out-of-pocket costs as a result. This could happen especially in situations where the shared service provider agency has to recover all agency costs, including overhead, in its rates.
- The consumer agency is still depreciating the investments it made to provide the service in house.

**If it makes sense for the state, why does the agency impact matter?**

When confronted with a shared service price, potential consumer agencies will consider whether this price can be accommodated within the agency's budget. If the agency's out-of-pocket costs increase significantly, they may have a problem.

This problem can be eliminated by funding the shared service provider directly with a general fund appropriation. Under the current realities of the state budget, however, it is unlikely that many IT shared services would be funded through a general fund appropriation. (When shared service costs are billed to all fund sources, the state general fund usually pays only half of the total cost of the service.)

Thus most shared services costs will be recovered through charges to service consumers. The impact of an increased out-of-pocket cost can be mitigated for agencies receiving appropriations by increasing their appropriation sufficient to cover the cost increase (and reducing the appropriation to agencies who will receive a cost savings).

However, agencies paying for services with dedicated funding sources will not receive an actual appropriation. To cover the shared service cost increase, they will have to either use existing fund balance if that is available, find savings somewhere else in their budget or, as a last resort, consider raising fees or revenues assuming permission can be received to do so (unlikely).

These kinds of anomalies can prove to be a significant barrier to the credible implementation of shared services. (“I thought this was supposed to save money?”) These concerns need not be a show-stopper for implementing a shared service that makes sense for the state. But the service provider should be aware of potential financial losers and consider ways to mitigate the situation.

3. How does the price compare to what the private sector charges for this service?

If the proposed shared service is one that is also available in the marketplace, people will naturally compare the shared service price to the market price. If the shared service cannot be offered at market price or better, the shared service should not be offered unless other non-financial benefits (e.g. security, risk reduction) make the state government offering worth this price premium.

**Do considerations differ if the service is required or is an optional multi-agency service?**

When an enterprise utility shared service is proposed for use by all or most agencies, the proposer should address each of the questions above. The statewide impact and scope of potential change raises the bar of scrutiny.

For a smaller-scale multi-agency service, it may only be necessary to address the second two questions. Potential consumers will assess the price and value of the service offering relative to alternatives to determine whether to use the service. In cases where the proposer would need to request start-up capital for the optional service, however, they would likely need to prepare a smaller scale assessment to make the business case for funding.

## Recommendations

- Develop an easy-to-use cost comparison model that would help shared services proposers and decision-makers analyze whether the proposed offering makes financial sense.
- A budget approach is needed to enable the state to take advantage of alternatives that reduce the total cost to government without causing financial hardship to individual agencies.

## What do providers need to finance the service?

Providers need financing tools and dollars

The shared service provider will need some financial tools and, perhaps, some start-up money to stand up the service and make it available to others.

Access to an internal service fund and permission to recover costs

An internal service fund is a type of account used by government entities providing services to other government entities in a manner similar to those in the private sector. Rather than receiving an appropriation to cover costs for a set period, activities in an internal service fund collect revenue for their services and retain an ongoing fund balance.

**The Data Processing Revolving Fund might offer an account mechanism for IT shared services**

The Data Processing Revolving Fund (Fund 419) is an internal service fund established to support a business-type financing model for IT services <http://www.ofm.wa.gov/fund/400/fund419.htm> . While current users of the fund are primarily those listed in law (DIS, OFM, DOP), the statute does allow for DIS and OFM to approve other users.

This could provide an important financial vehicle for IT shared service providers. The Shared Service Governing Board, through OFM and DIS, could manage a process to review and approve access to the fund for shared services operations.

Shared service providers also need permission to recover costs for the services they provide. Whether access to an internal service fund automatically conveys that authority needs to be confirmed.

**A way to cover start-up and capital costs**

When entrepreneurs have promising new business ideas, they seek investment capital to start operations. The capital covers the costs of infrastructure, set-up, and initial operations. As the business operates successfully it repays the investors over time and provides enough revenue to be self-sustaining.

Shared service operations have the same needs for start-up and infrastructure financing. If the shared service provider has to recover these initial costs as they go, early adopters of the service will pay a disproportionate share of the start-up costs. Also, it will be very difficult for the price to compare favorably to market offerings.

**Appropriation or investment capital?**

Here are several ideas for how to finance shared service start up costs.

- Fund the start-up and infrastructure costs with an appropriation in the budget. In this case rates would not have to include these initial one-time costs.
- Provide a one-time infusion of capital into the Data Process Revolving Fund to be used as seed money for IT shared service initiatives. OFM and DIS, or a new shared service governance body, could manage a process that would determine which shared service proposals would receive start-up funding. These shared services providers could make up-front investments and then depreciate these costs over time. Rates would be set to recover these depreciation costs, restoring the capital to the fund to be available for future shared service proposals. Some benefits of this approach:
  - Because the start-up costs are spread over a reasonable recovery period, rates would be more affordable and comparable to the private sector.
  - This approach is also consistent with the federal government’s move to disallow application development costs from administrative cost reimbursement, but allow depreciation costs of those assets to be reimbursed.
  - This approach does not require waiting for budget windows to move forward with good ideas.
  - This approach is especially suited to small-scale, optional shared services, where a number of agencies would like to come together to minimize costs of operations.

This second approach would be a relatively new approach for state government. It might make sense to pilot this approach with one or two initial services, to gain experience and confidence with such a mechanism.

- A variation of this approach would be to accumulate this capital by adding a temporary minor surcharge on bills of providers currently using the fund (OFM, DIS, and DOP). When the agreed-upon capital fund amount was reached, the surcharge would be removed from the billings. Use of this investment fund would operate in the same manner as described above.
- Sometimes several agencies can achieve more than they could alone by pooling their existing resources. Providing some mechanism, like access to the Data Process Revolving Fund to enable agencies to pool the funds necessary to implement a cost effective shared service would be an approach that could work in some circumstances without new funding being required.

Help in establishing a successful chargeback process

We assume that in most cases, shared services costs would be recovered through some kind of chargeback process to consumer agencies. Providers may need guidance and assistance in how to set up a successful chargeback process.

A complete cost recovery process includes the following components:

- Cost recovery principles and objectives
- Cost recovery structure definitions (e.g. cost classifications, cost pool definitions, cost allocation rules, service unit and consumer definitions, timekeeping data elements, etc.)
- Pre-implementation chargeback modeling
  - Consumer demand and unit estimates
  - Cost-to-meet demand estimates
  - Service cost modeling
  - Pricing analysis
  - Consumer cost impact modeling
- Service and cost definition refinement with consumers
  - Rate/cost preview
  - Service level agreement discussions
  - Budget revisions and model updates
  - Finalizing budget, rates, and service levels

- Service delivery – cost and other data capture
- Cost recovery
- Data analysis and refinements
  - Actual vs. planned

While a central IT service agency provider may have expertise and tools to support each of these components, an agency wishing to offer a small scale shared service may need help in one or more of these areas.

## Things to think about when setting service prices

In setting a price for the shared service, providers need to think about a price that meets key consumer criteria, provides financial stability, manageability, and continuous improvement, and meets federal and state audit requirements.

### Consumer criteria

The provider should think about the consumers' financial priorities and how they affect the pricing approach. Here are some fundamental issues for consumers:

- **Simplicity** – Is the billing method easy to explain and understand?
- **Transparency** – Can the consumer really know what they are paying for?
- **Fairness** – Will consumers feel they are paying for a fair share of the service?
- **Predictability** – Is there an assurance that there will be little difference in what the consumer budgeted for service and the actual charge?
- **Controllability** – If this is a usage based rate, does the price give the consumer some opportunity to actively manage their IT costs?
- **Comparability** – Does the service definition and the pricing method enable the consumer to compare the cost of the shared provider with other options?

**Providing manageability and stability for the provider**

Traditionally chargeback models have been associated with usage-based fees, but depending on the type of service being offered this is not always the most feasible or sustainable choice for the provider. Many services have a significant fixed cost component; significant usage variance may mean that costs are not recovered. Other services have an enterprise purpose where the usage patterns of individual agencies do not capture the relative value of the service.

Providers should consider several different models to find one that will best balance their needs for financial stability with the consumer concerns mentioned above.

- **Access charges** – Charges are based on the ability to access certain functions, usually for a flat fee. This may or may not be part of subscription service.
- **Subscription** – Charges are based on flat fees for various components that may be independently priced (service menu). In this case, the subscription fee usually is based on an agreed-upon period of time. The fee is not based on usage, but rather on access; functionality and service levels are generally fixed.
- **Tiered usage** – Charges are based on pre-established ranges of use. If actual usage remains within the contracted “tier,” then a flat monthly fee is charged. These components can also be included in a subscription package.
- **Usage** – Charges are variable, a price per unit.

**Meeting federal cost recovery requirements**

The federal government has rules for what are considered allowable costs to be charged to federal programs. Shared service rates need to have a reasonable nexus to the benefit received by the federal program. Also, the federal government will pay for the usage of capital assets but will not participate in the cost of building an asset. Thus it is preferable if rates include only the depreciation related to a capital asset and not the initial cost of the asset.

If individual agencies receive a portion of federal funding and are asked to participate in the funding mechanism, approval will probably be needed from their federal counterparts.

Billing tools and services	The provider agency will need tools and capacity to bill agencies for the shared services they use. This billing activity could in itself be a shared service offered by DIS or some other agency with an invoicing operation already in place.
Recommendations	<ul style="list-style-type: none"> <li>• Confirm that the Data Processing Revolving Fund could be used by other agencies as the account for IT shared services activities. Also confirm what legislative approval is needed, if any, for shared services to be established and for billings to consumer agencies to occur.</li> <li>• Propose a budget request to provide capital for some specific initial IT shared services. Use this effort as a proof of concept.</li> <li>• Perhaps restructure the fund management of the Data Processing Revolving Fund to provide more opportunity for strategic direction and use of its capital.</li> </ul>

## What do consumers need to be able pay for the service?

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Budget authority and capacity	As required by RCW 39.34.130 agencies receiving shared IT services would be expected to reimburse the shared service provider for the full costs associated with providing the service. Within the constraints of legislative intent and fund source restrictions, agencies would usually have authority to switch to a new service provider “vendor” for something already planned to be purchased in the base budget. However, if additional budget authority is needed, the receiving agency would need to request that authority through the normal budget process.
Price and service level information	<p>The previous section discussed the essential components of a successful chargeback system. Many of these components ensure that the consumer has the information needed to make good business decisions. For example consumers need to:</p> <ul style="list-style-type: none"> <li>• Understand the prices and the cost control levers they have as consumers</li> <li>• Understand the service being offered and the level of service received for the price</li> <li>• Be able to compare the price to alternatives</li> </ul>

## Other critical considerations

- Consumers need sufficient lead time to adjust to pricing changes.
- Ideally price changes are incremental and small enough to be manageable.
- Consumers want a chance to be involved in and influence the rate setting process.

## Recommendations

- Take a strategic and comprehensive look at the state's Statewide Indirect Cost Allocation Plan (SWICAP—the plan approved by the federal government for how the state's administrative costs will be treated in federal grants) to ensure it provides the maximum benefit to state business flexibility and to federal grant reimbursement for administrative type costs. Work with a federal cost auditor on proposed changes that would better support shared service objectives and still meet federal requirements.
- Confirm the budget authority constraints on consumer agencies that might preclude them from buying services from a new shared service provider.