



ACHIEVING SIGNIFICANT O&M REDUCTION WITH RISK-INFORMED BUDGETING

As MCR has previously noted, utilities are facing increasing cost pressure. Despite growing demand and high reliability expectations, utilities are expected to limit rate increases. Utilities are left with no simple options to manage these conflicting objectives and still maintain strong profitability and returns.

To address financial pressures, utilities frequently look to traditional cost-cutting methods: flat percentage or across-the-board budget cuts, staff reductions, or deferred project spending. While these traditional methods may achieve some results, a more analytical approach to optimize spending will help ensure the right funding is applied to the right efforts at the right time.

Risk-informed budgeting (RIB) is an analytical approach in which the timing, amount, and consequence of every budget line item is challenged. In our experience, an effectively implemented RIB program can produce 10% to 15% savings in routine budgets, even after implementing other cost reduction initiatives.

The Deficiencies of Traditional Budgeting

Traditional budgeting typically relies on an incremental approach—the prior year’s budget is accepted as a baseline, and percentage increases or cuts are used to meet financial goals. This approach is easy to implement and repeat annually, often through executive-mandated reductions applied uniformly across the organization. The results are typically superficial, and executives often feel they left something on the table. Compounding the issue, the lack of detailed review institutionalizes an assumed base level of spending. As a result, recurring spending becomes part of the operational budget paradigm, and overspending is perpetuated from year to year.

Risk-Informed Budgeting

At its core, RIB, based on MCR’s approach to zero-based budgeting, requires budget owners to provide risk justification for all budget requests. In contrast to traditional incremental budgeting, which continues



past spending without real scrutiny, RIB's key strength is the detailed examination of every dollar, focusing on what is needed to operate in a safe, reliable, and efficient manner. RIB drives the following key cultural changes:

- Challenge the status quo
- Accept history as a guide, but not a justification
- Articulate why each cost center does what it does, and the value it brings to the utility's overall objectives
- Identify the consequences of not funding a specific budget line item

RIB requires hard work and a greater time investment than traditional budgeting. It demands deeper scrutiny by budget owners, more rigorous review by those challenging the budget, and the management of additional data, questions, and decisions. However, it's a low-risk investment producing significant returns.

A successful RIB solution is built around three critical components:

- 1) **Structure:** a well-thought-out, formal structure defining how budgets should be organized and presented
- 2) **Challenge:** an effective approach to challenge or question each budget item as it is presented, enhanced with artificial intelligence (AI) where appropriate
- 3) **Tools:** tools and a database to manage, sort, and report the budget in real time as it is reviewed and decided upon

The Risk-Informed Budgeting Structure

An effective RIB structure goes beyond typical budgeting by organizing all budget dollars into categories to support the required intensive review. The categories define the criticality of expenditures, indicate an organization's ability to influence the timing or amount of each budget line item, and provide insight on the anticipated value from the requested dollars.

RIB categories typically focus on criticality, which spans the following range:

- **Critical:** funding *is required* for continued operation of the business function; management has little to no control over these expenditures
- **Enhancing:** funding *will enhance* safety, reliability, operational, regulatory, business, or organizational effectiveness; management has some control over these expenditures
- **Discretionary:** funding *may enhance* safety, reliability, operational, regulatory, business, or organizational effectiveness; management has complete control over these expenditures



The assignment of budget requests to RIB categories is not a prioritization of those requests. Rather, it is a way to assess where there is flexibility to adjust the timing and/or amount of O&M spending. In practice, some low-flexibility category requests will be funded, while funding for some high-flexibility category requests will be reduced or delayed.

The Challenge Process

Organizing budgets by categories is important, but not sufficient. Without robust conversation, the categorization of budget items is little more than a paperwork exercise producing no measurable impact. This conversation—the challenge process—requires each organization to present its budget requests and defend them. The process should not be adversarial, but it does need to be serious and arrive at a common understanding of budget necessity.

The challenge process centers on direct questions about budget dollars and categories. Examples of direct questions include:

- Is this really a regulatory requirement? Can you show me the regulation?
- Do we have to do this next year? What is the impact of a delay?
- This budget request is based on the manufacturer's maintenance guidelines; what have other plants experienced with this equipment?
- Is this request truly critical? Haven't other utilities around the country addressed this issue in a different and more cost-effective manner?
- Is this the most cost-effective approach? What alternatives were assessed?
- Why do we have varying budget requests across the utility for travel costs, membership fees, and office supplies, all of which are supposed to be controlled under a common set of policies?

Without robust conversation, the **categorization of budget items** is little more than a paperwork exercise producing no measurable impact.

The challenge process may be conducted by the utility's financial organization, the executive team, or a middle-management budget team. Regardless of structure, it requires significant time to review each request in detail, meet with organizations, follow up on questions, and evaluate the entire budget. Most importantly, those challenging the budget must be prepared to ask difficult questions, push back on unclear justifications, insist on fact-based alternatives, and make decisions.

As the challenge process progresses, budget requests are approved, reduced, deleted, deferred, or designated as contingency, with categorizations frequently adjusted and alignment with the utility's goals questioned. A strong challenge process builds consensus on what needs to be spent in the coming year, resetting the budget to reflect actual need rather than past practice.

Exhibit 1 illustrates how budget requests are challenged and dollars shift among categories as decisions are made.

Exhibit 1: The Challenge Process

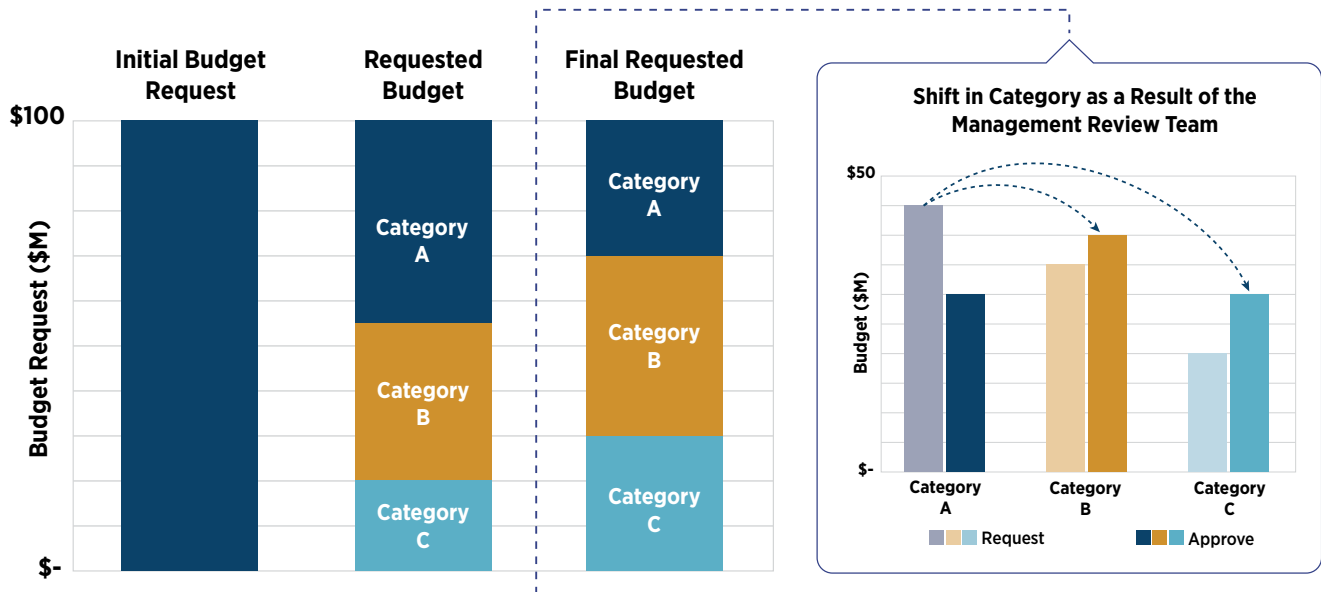
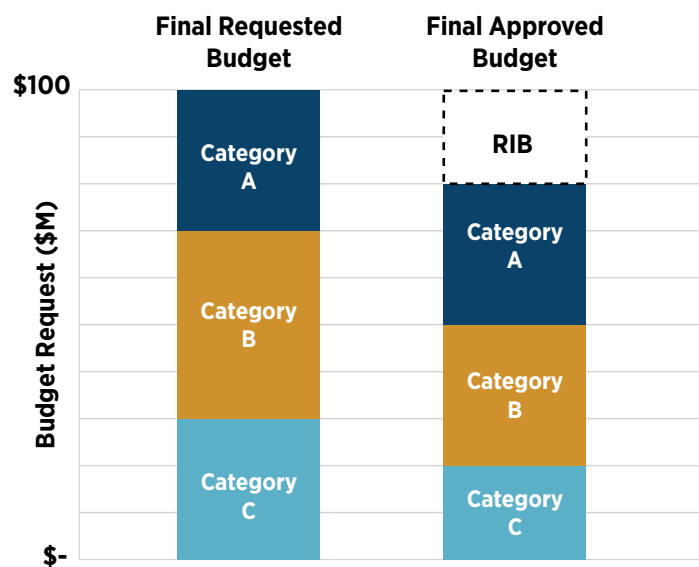


Exhibit 2 illustrates part of a RIB tool. The graphic compares the final requested budget by category with the final approved budget. The dollars in the RIB box represent the cost reductions realized through the RIB process, which can flex up and down as spending decisions are altered.

Exhibit 2: The Risk-Informed Budgeting System





Tools and Supporting Infrastructure

The final components of a successful RIB program are the tools and infrastructure required to support successful conduct of the process. These tools include:

- Training materials to inform participants of their roles and responsibilities
- Budget templates to clearly define budget categories, assignments, and other required information
- A custom AI agent to accelerate the categorization process
- A carefully defined database to track budget decisions and support uploading into the corporate budgeting system

Data reporting and control are critical to easily answer questions and provide leaders line of sight to category allocations and departmental impacts. Answering these questions quickly and tracking substantial amounts of information, while still maintaining congruency with budget and financial platforms, requires a well-thought-out database and reporting system.

The most time-consuming step in RIB has traditionally been line-by-line categorization of budgets, often taking weeks and limiting time for meaningful challenge discussions. MCR has successfully addressed this by piloting an AI agent to automate the initial budget review and categorization, eliminating a major administrative bottleneck. What was once labor-intensive is now automated, freeing teams to focus on the challenge process. Most notably, AI now makes rigorous RIB practical for smaller utilities that previously lacked the resources to do so.

It's equally important for participants to have a clear understanding of the RIB process and how it's implemented. Successful execution is brought about by training all participants, whether they are budget owners filling out templates, the budget group organizing and reporting on submissions, or the management team reviewing requests and making decisions. Each individual needs to know what their role is, how they fit into the process, and the expectations required for success.

An Investment You Can't Afford to Miss

RIB offers utilities a new approach, which can be used to achieve significant cost efficiency and address the ever-increasing financial pressures caused by changing market dynamics.

RIB is hard work. It requires significant planning and the efforts of a dedicated team. Is the RIB effort worth it for your company? For many utilities, an approach yielding cost reductions of 10% to 15% seems to be a wise investment. Done right, RIB is part of the industry's best hope to maintain strong returns in a challenging market.



About the Author

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Tim is a Vice President at MCR and leads the Nuclear Generation practice. He has more than 30 years of utility industry experience in nuclear power plant operations, maintenance, work control, business operations, process improvement, and technology solutions, and he has achieved significant performance improvements for his clients. Tim provides the often-elusive connection between corporate strategy, long-range planning/budgeting, work management, and technology through industry-leading life cycle management practices.

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