

# Zero-Base Budgeting Concepts and Examples

City Council, Item 338

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Independent Budget Analyst





# City Council Financial Training Program

**Adopted in 2006: Information presented to Council twice a year covering topics in one of four financial subject areas:**

- **Current and Multi-Year Budget Planning**

Today's topic: Zero-Base Budgeting (ZBB)

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- **Financial Statement Overview**

- **Debt Issuance and Administration**

- **Financial Disclosure**

# Background

January 2015: Councilmembers Sherman and Cate requested a ZBB pilot program

Performance & Analytics and Facilities Division of Public Works General Services selected for ZBB pilot

FM used ZBB service-based budgeting approach to develop these budgets in FY 2017

May 2016: FM issued memorandum updating Council on the ZBB pilot process

# Presentation Overview

- Description & history of ZBB
- How ZBB works in theory
- Advantages/drawbacks associated with theoretical ZBB
- Information from other jurisdictions using ZBB
- Concluding thoughts/considerations

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Financial Management will discuss the ZBB concepts utilized for Performance & Analytics and the Facilities Division of Public Works

## Theoretical ZBB - What is it?

- Annual budget process starts from a base of zero
- Differs from incremental budgeting where the starting point is the prior year's budget
- In theory, ZBB requires every budget request line be thoroughly evaluated & approved
- Tasks/goals are identified/prioritized; funding is allocated irrespective of what was previously budgeted

## Brief History of ZBB

- Some use in private sector during the 1960s
- Governor Jimmy Carter develops ZBB system for Georgia in early 1970s, borrowing from private sector practices
- President Carter implements ZBB at federal level in 1977
- Federal government ceased ZBB in 1981, although elements of ZBB remained until 1994
- Use of ZBB in public sector subsequently declines
- Appears to be renewed interest when governments face major fiscal challenges

## How ZBB Works in Theory

- Systematic review & justification of funding/performance levels of current programs
- Past patterns of spending no longer a given
- Organization divided into “decision units”; at least 3 alternate funding levels (decision packages) established for each decision unit
- Priorities established based on program results that could be achieved at alternative spending levels

## How ZBB Works in Theory (continued)

- Decision packages include:
  - Detailed information on inputs (dollars, FTEs, etc.)
  - Specific performance measures to explain impact of alternative funding packages on service levels
- Decision packages ranked from highest to lowest priority
- Department directors/management make budget decisions based on rankings/desired service outcomes



## Cited Advantages of Theoretical ZBB

- Rational & comprehensive method for reducing budget
- More efficient allocation of resources—based on needs & benefits rather than history
- Enhances transparency, accountability and decision-making
- Provides better insight into detailed activities of departments
- Focuses on performance measures & results for various decisions/programs

## Cited Drawbacks Associated with Theoretical ZBB

- Requires substantial time commitments from staff & management
- Reluctance of managers to suggest decision packages below current spending levels
- Lack of buy-in can lead to “gaming” of the system
- ZBB decision package options often driven by management preferences; may not reflect views/priorities of elected officials or public
- Developing varying service level packages can be challenging

## ZBB in Practice Today

- GFOA research suggests ZBB is rarely practiced
- Theoretical ZBB has drawbacks/challenges that make it difficult to use for all departments in a large organization
- Elements of ZBB are used by several jurisdictions in the public sector—often with positive results
- ZBB concepts can be effectively used in conjunction with more traditional budgeting methods
- IBA interviewed jurisdictions currently using ZBB concepts

# State of Georgia

Review of activities against statutory responsibilities, purpose, cost to provide services & desired performance outcomes

Four step process:

1. Identify & evaluate key activities
2. Develop & evaluate performance measures
3. Analyze program budget to assess cost effectiveness/ROI
4. Summarize analysis/develop budgetary recommendations

# State of Georgia (continued)

## Benefits:

- Legislature heavily involved
- Larger agencies can be reviewed over several years
- Improved understanding of activities
- Sunset provision included

## Challenges:

- Implemented after recession
- Two large departments reviewed in one year
- Some efficiencies could have been accomplished through normal budget process

# City of Seattle

## Baseline budget review

### Goals:

- Improve understanding of department's baseline budget
- Effort to connect budget planning activity with actual revenues & expenditures

### Benefits:

- Improved understanding of activities & programs
- Recognition that accounting system did not accurately represent how funding was allocated
- Improved understanding of expenditure categories

# City of Seattle (continued)

## Challenges:

- Further implementation delayed until after new accounting system in place

## Lessons Learned:

- Importance of emphasizing this broader review is not a budget reduction process

# Montgomery County, Pennsylvania

## Mission-based approach

### Phase 1:

1. Describe core mission
2. Identify performance measures to achieve mission
3. Identify how activities meet mission
4. Design ideal organizational structure to accomplish mission

### Phase 2:

- Identify forecasted revenues & expenditures; evaluate how they line up with Department's mission & services



# Montgomery County (continued)

## Benefits:

- Identified duplicative services & non-mission critical services
- More than a cost cutting effort

## Challenges:

- Time consuming
- Push-back from Departments

# City of Chicago

## Zero line-item approach

### Process:

- Non-personnel expenditures zeroed out each year; departments justify requests for each line-item

### Benefits:

- Identification of incorrectly categorized expenditures
- \$21.7 million in identified savings in FY 2016
- Significant buy-in from departments

# City of Chicago (continued)

## Challenges:

- Outdated accounting system limited ZBB use

## Lessons Learned:

- ZBB is not one-size-fits-all

# City of Calgary

Zero-based reviews of certain business units conducted outside of budget process

## Process:

1. Data collection
2. High-level review of unit's services
3. External consultant hired to conduct in-depth review
4. Council review/adoption of recommendations
5. Business unit returns to Council with implementation plans

# City of Calgary (continued)

## Benefits:

- Removing review from budget process improved results
- Council actively engaged in process
- More than a cost-cutting measure

## Challenges:

- Costly process (\$1.35M budgeted/year)
- Lengthy process

# Conclusion

## Potential Advantages

- Provides better insight into department activities & related costs
- Offers more rational method for making budget cuts when necessary
- More detailed review of all expenditures ensures accountability
- Enhances transparency & decision-making by comprehensively examining entire budget rather than focusing on incremental change
- Focuses on performance measures & results for various decisions/programs
- Beyond cutting costs, it can identify effectiveness improvements or be a useful tool for reallocating limited resources within departments

# Conclusion (continued)

## Potential Drawbacks

- Requires substantial time commitment
- Lack of staff buy-in can lead to implementation challenges
- ZBB budget decisions often driven/shaped by management preferences, and may not reflect the views/priorities of elected officials or public
- If ZBB is viewed only as a budgetary cutback process, effective implementation may be challenging

# Conclusion (continued)

## Implementation Considerations

- Critical to have support & commitment from both government leadership and department, division & program managers
- Use ZBB processes that are practical and meet identified budget objectives
- Instead of reviewing all departments at once, it may be more effective to conduct ZBB reviews for certain departments/programs on rotating basis
- Outside subject matter experts can assist with ZBB reviews, although this can increase costs & result in concerns/differences of opinion with department staff
- Incompatibility with the City's current budget system