Zero-Base Budgeting Concepts and Examples

City Council, Item 338
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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

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