

Zero-Base Budgeting

ZERO-BASED BUDGETING - The process of preparing an operating plan or budget that starts with no authorized funds. In a zero-based budget, each activity to be funded must be justified every time a new budget is prepared. (Lectric Law Library)

Zero-Base Budgeting An Overview¹

Background and Nature of Zero-Base Budgeting

Zero-Base Budgeting (ZBB) was first developed and introduced for business by Peter A. Pyhrr. During the development of ZBB Mr. Pyhrr was the Manager, Staff Control, at Texas Instruments, Inc. Dallas. From this beginning ZBB has been explored and adopted by many other businesses. Some state and federal government departments have adopted and put into practice the management concepts of ZBB. Also, various school districts have chosen to use the ZBB model for managing their educational operations.

Major Processes of Zero-Base Budgeting

The development and implementation of the ZBB model requires managers and others in the organization to engage in several major planning, analytic and decision-making processes. These major processes of ZBB include the following:

1. Definition of the Mission and Goals of the Organization

Usually the organization has already established mission and goal statements. However, it may be necessary to redefine the ones that are already in existence and/or create new ones. This redefinition is particularly useful when there have been major changes in the internal and external environment.

2. Identification of the Organization's Decision Units and Decision Packages

A ZBB decision unit is an operating division for which decision packages are to be developed and analyzed. It can also be described as a cost or a budget center. Managers of each decision unit are responsible for developing a description of each program to be operated in the next fiscal year or years. In ZBB these programs are referred to as decision packages and each decision package usually will have three or more alternative ways of achieving the decision package's objectives. Briefly, each decision package alternative must contain, as a minimum, goals and/or objectives, activities, resources and their dollar costs. Also, the decision package should contain a description of how it contributes to the mission and goals of the organization.

3. Analysis of Each Decision Package

This analytic process allows the manager of the decision package and its alternatives to assess and justify its

operation. Several questions should be asked and answered during the analytical process.

- ✍ Does this decision package support and contribute to the goals of the organization?
- ✍ What would be the result to the organization if the decision package were eliminated?
- ✍ Can this decision package's objectives be accomplished more effectively and/or efficiently? This question will require creative planning by the person(s) developing the decision package.

4. Ranking of Decision Packages

The ranking process is used to establish a rank priority of decision packages within the organization. During the ranking process managers and their staff will analyze each of the several decision package alternatives. The analysis allows the manager to select the one alternative that has the greatest potential for achieving the objective(s) of the decision package. Ranking is a way of evaluating all decision packages in relation to each other. Since, there are any number of ways to rank decision packages managers will no doubt employ various methods of ranking. The main point is that the ranking of decision packages is an important process of ZBB.

5. Acceptance and Allocation of Resources

Managers, following a review and analysis of all decision packages, will determine the level of resources to be allocated to each decision package. Managers at different levels of responsibility in the organization usually perform the review and analysis. Sometimes, the executive levels of management may require the managers of the decision packages to revise and resubmit their decision packages for additional review and analysis.

6. Budget Preparation

The organization's budget is prepared following the acceptance and approval of the decision packages. Once the organization's budget has been approved managers of the decision units will place in operation all approved decision packages during the next fiscal year.

7. Monitoring and Evaluation

The last major process of ZBB is monitoring and evaluation. The processes of planning, analysis, selection and budgeting of decision packages prepare the organization for operation during the next year. However, what managers plan to happen in the next fiscal year may or may not occur. Adjustments may be essential during the year in order to achieve the decision package objectives. Also, there is a need to know whether or not the organization did accomplish what it set out to achieve and what level of achievement was obtained. The monitoring and evaluation process of ZBB requires that the following be included in the overall design and implementation of decision packages.

Decision package content should include:

- ✍ Measurable performance objectives
- ✍ Appropriate activities as means for achieving the performance objectives

¹ <http://www.swb-inc.com/zbb.htm>

- ✍ Resource allocation essential for conducting the activities
- ✍ Methods for carrying out the activities as planned
- ✍ Evaluation of objective achievement during and at the end of the program of activities
- ✍ Procedures for reporting objective achievement to managers of the organization

- ✍ Develop and/or modify their organization's mission and goals
- ✍ Establish broad policies based on the mission and goals
- ✍ Efficiently identify the most desirable programs to be placed in operation
- ✍ Allocate the appropriate level of resources to each program
- ✍ Monitor and evaluate each program during and at the end of its operation
- ✍ Report the effectiveness of each program

The Importance of Planning

A major planning effort is required by personnel of an organization when installing ZBB. It is through the planning process that important guidelines and directions are provided for the development and ranking of the decision packages. Also, the planning process enables managers to prepare for the uncertainty of the future. Long-range planning allows managers to consider the potential consequences of current decisions over an extended time period.

The common components of the planning process are:

- ✍ Development of the organization's mission and goals
- ✍ Generation of broad policies to guide and direct the organization
- ✍ Establishing and documenting the client or customer needs
- ✍ Preparation of decision unit goals and/or objectives
- ✍ Creating a set of organization priorities
- ✍ Resource identification
- ✍ Decision package analysis, resource allocation and selection
- ✍ Budget preparation

Adherence to concepts and procedures of ZBB will result in the following:

- ✍ Retention of desirable decision packages (including modification as may be necessary)
- ✍ Elimination of obsolete, non-relevant decision packages
- ✍ Increased or decreased levels of funding for some decision packages
- ✍ Addition of new decision packages

The ZBB planning process eliminates one of the major disadvantages of most traditional management and budgeting systems. Typically, in the traditional budgeting system, planners focus on the incremental cost increases from year to year. ZBB overcomes this traditional budgeting weakness by subjecting all proposed programs and expenditures to the type of scrutiny that is normally conducted for new programs. The comprehensive resource cost analysis process is a strong internal planning characteristic of ZBB.

Summary

ZBB addresses and supports comprehensive planning, shared decision-making, the development and application of strategies and allocation of resources as a way of achieving established goals and objectives. In addition, ZBB supports the added processes of monitoring and evaluation. ZBB when properly implemented in an organization can assist managers to:

ZBB, when properly implemented, holds great promise for assisting personnel of an organization to plan and make decisions about the most efficient and effective ways to use their available resources to achieve their defined mission, goals and objectives.

Zero Based Budgeting (City of San Diego)²

PURPOSE

- ✍ ZBB based upon premise that service & overhead levels can be changed without reducing overall service mission
- ✍ To provide thorough evaluation of every function as to priority and mode of service delivery
- ✍ Establish "decision packages" which permit budget decisions based upon value of the service rather than cross the board reductions
- ✍ ZBB produces performance standards against which functions are measured throughout the year

Is the Promise of Zero-Based Budgeting Too Good to be True?³

By Ralph Heller (2/12/1999)

Politicians, officials and bureaucrats are especially adept at marketing their efforts and programs with seemingly reassuring phraseology to instill public confidence. But as often as not, the promise is no more reliable than those presenting it.

Consider the popular and over-used phrase "zero tolerance," beloved by district attorneys, sheriffs and police chiefs who use it to convince the public that cavalier attitudes toward the law and mistreatment of individuals won't be tolerated. But what the public is never told is that "zero tolerance" applies to some citizens but not to others.

In recent years in Nevada an innocent man named John Paiva was needlessly gunned down at his own front door by police in a hail of gunfire, but none of the malefactors were prosecuted or even lost their jobs. A young man driving too fast in a rural area was recklessly rammed from behind and killed by a sheriff's deputy driving like a drunken madman, but no one was prosecuted and the deputy is still in uniform.

More recently a young man named Ben Hull was savagely gunned down and killed in his own living room by sheriff's

² <http://www.co.san-diego.ca.us/cnty/bos/slide/sheehan/tsld020.htm>

³ http://www.npri.org/op_eds/op_ed99/o_e021299.html

deputies but no one has been prosecuted or even lost his job. And in Washoe County a couple of deputy district attorneys and a police officer went joyriding one night, stopping to urinate in somebody's water bottle and letting the air out of tires on a couple of cars, and finally firing a gun into a nearby hillside ... within city limits. Nobody was prosecuted, but what do you think would have happened had you been the culprit?

Accordingly, we now come to another phrase like "zero tolerance," one unlikely to be more useful or effective than those utilizing it, "zero-based budgeting." Ostensibly, "zero-based budgeting" is an exercise in justifying government functions and expenditures function by function and department by department; "Good morning, I'm from the governor's office. Who are you, what do you do, and can you justify for me the money you spend?"

We have now set the stage for bureaucratic grandstanding, but what if we began our interrogation by comparing per capita costs function by function in Nevada with per capita costs to perform the same functions in other states? With appropriate comparisons in hand, and armed with detailed knowledge of the history of each government function and department, "zero-based budgeting" can be helpful, but without such detailed knowledge and history and such state-by-state comparisons, "zero-based budgeting" is likely to be pointless.

Less than two months ago President Clinton asked Congress for a substantial increase in defense spending. Mindful of today's dangers and political instability in country after country from Kosovo to Haiti, most Americans would tend to support the increase requested. (And yes, U.S. troops are still in Haiti, even if your favorite newspaper has forgotten them).

But let's add a few additional facts that may otherwise escape your attention. During World War II the U.S. Navy had one admiral for every 130 ships, whereas today it has one admiral for every 16 ships. Similarly, during World War II the Air Force had one general for every 244 planes, whereas today it has one general for every 23 planes.

Most Americans might still want to spend a bit more on defense, but perhaps not until they have been provided with an explanation of why today's military is so much more top-heavy with brass than the military that won the greatest war in history.

Obviously, "zero-based budgeting" is unlikely to be better or worse than the knowledge, insight, dedication, intelligence and curiosity of those utilizing it. At this moment the city of Reno—a small city by U.S. standards, with only 174,000 people—has a City Hall Public Relations and Marketing function of eight full time employees with a budget of almost \$1 million. In the abstract, doubtless City Hall could justify the staff and the expense for inquiring "zero-based budgeters."

But what if someone had first researched the size of public relations staffs and budgets for, say, 50 or 100 U.S. cities with populations between 150,000 and 200,000? With such comparisons at hand "zero-based budgeting" can suddenly become very useful. Not only will the city's bureaucrats and

politicians have to justify the expense in terms of function, they will also have to demonstrate why the function is so much more (or less) costly than it is in other cities of similar size.

Let's be wary of phrases like "zero-based budgeting." In responsible, intelligent hands, utilized by people possessed of a high level of intellectual curiosity and imagination "zero-based budgeting" can be helpful. But in the wrong hands, and not backed up by comparative knowledge and research, it is likely to be no more meaningful than phrases like "zero tolerance"—a convenient phrase for public relations oriented officials but of little meaningful use.

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The Evolution of State Budget Processes⁴

From "Fundamentals of Sound State Budgeting Practices"
National Conference of State Legislatures

Writing a budget for a state government involves the most complicated and controversial issue in public life: how the public's money gets spent. Given the number and variety of interests and issues that have to be reconciled for a budget to be completed, the wonder is that the process moves along as smoothly as it does year after year. But for many observers, it is the competitiveness, compromises and incomplete nature of the process that are striking, not the real accomplishment every annual and biennial budget represents.

Because budgets have so many functions, the process of writing one is often conflict-ridden, unsatisfactory to observers and participants and flawed in its outcomes. Budgets seem to increase rather than resolve partisan competition; they sometimes are late; they leave problems unresolved; they spend too much or too little; they may fail to include adequate program review, planning for the future, accounting for past expenses, or controls on planned spending.

These complaints have shown up ever since formal, comprehensive budgeting became a feature of state and local government in the early years of the 20th century. The Taft Commission, which examined federal budget processes in 1912, criticized federal budgeting procedures for the same flaws observers note today. Some of the problems - partisanship, indecisiveness, and lack of closure - are inherent in the democratic process. Others spring from conflicting expectations of the process. The central function of a budget - the decision of how much to spend for what - will always create disputes, and no budget will ever satisfy everyone.

"The power to tax involves the power to destroy," said Chief Justice John Marshall, and it is equally true that the power to spend is the power to create. Budgets are documents that express state governments' power to act. They summarize policymakers' evaluations of past programs and public agencies and their forecasts of current and future needs and resources. Budgets set goals, decide among alternative

⁴ <http://www.jfac.state.id.us/Evolution.htm>

objectives, and create means for controlling and accounting for the expenditure of public money. They can push reform or they can discourage it.

I. Evolution of State Budget Processes

A. Line-Item Budgeting

Line-item budgeting represented the earliest attempts at institutionalizing a budget process and bringing some kind of order to state government expenditures. Control is expressed in written budgets through "line items", which are simply statements or "lines" in an appropriation bill which simply define how much money can be spent for certain "items", whether its road equipment for the Transportation Department, fish hatchery raceways for Fish and Game or Drug Enforcement Agents for the Department of Law Enforcement. State Legislators have indicated a certain comfort with this approach in the past because it is restrictive in terms of defining expenditures and setting limits, and it is also simple to explain in terms of where the taxpayer's money is going. However, while Line-item budgeting provided the essential ingredients of order and control it does not address issues of performance, quality and accountability.

B. Incremental Budgeting

Incremental budgeting focuses attention on additions or deletions to the existing structure of state government. This budget approach usually takes for granted previous appropriations and structure, focusing on year to year inflationary changes, and building by small increments on past budget decisions. The incremental approach guides the discussion of budget decisions toward what money can buy, called an "input", versus the quality of the service that is provided, an "outcome". While it is certainly true that the quality of services in state government can be questioned in an incremental budget, it remains a fact of life in any budget process decision making that the format will have large and direct impact on policy discussions.

"These practices are under attack because they are said to foster a business-as-usual approach to government at a time when the public is challenging how state governments operate, questioning their efficiency and effectiveness, and expressing distrust of representative government itself. With growing concern about how well government functions, many people contend that the traditional focus on line-item budgeting and incremental change neglects outcomes so much that the budgeting process itself is an impediment to effectively delivering programs."

C. Program Budgeting

Program budgeting places considerable emphasis on designing budget architecture that groups expenditures and sources of funds into functional activity categories. In program budgeting terminology, a function is simply a group of related activities for which a governmental unit is responsible. The classification structure used in each government unit is a product of fiscal, organizational, and political considerations. The second Hoover Commission recommended that agencies

should "synchronize their organization structures, budget classifications, and accounting systems." If this were accomplished, both organizations and budgets would be structured functionally and tied together. This is a key aspect of program budgeting.

For instance, the Idaho Department of Fish and Game is divided into eight major programs along functional lines. One of those programs, the Fisheries program, is then broken down into smaller units, such as Resident Fisheries and Anadromous Fisheries, then each of those functions in turn is broken down into smaller units; etc.; etc. Program-based budgeting allocates resources by function, which in turn are divisible into activities.

The evolution and development of program budgets was a vast improvement to the state budget process, because it provided some functional perspective for decision makers. By organizing budgets into functional units the focus quite logically turned to the function itself and the delivery of services. The framework in this decision-making process begs the question, "what do you do and why do you need this money to do it?" The program budget formats in many states then began displaying goals and activities of a program to answer those questions, which then evolved into an examination of "workload measures" and the beginning of a serious evaluation of "performance measures".

D. Performance Budgeting

Performance Budgeting developed as a natural progression from Program Budgeting as Governors and Legislatures began looking at state government functionally. Performance Budgeting emphasizes the outcome of state programs, and attempts to measure the performance of state government, reward programs that work well, and redesign programs that do not work well.

"Performance-based budgeting calls for a revolution in how states are governed. It focuses on setting goals, designing the strategies needed to meet the goals, and measuring how well they are met. Future funding decisions should focus on program effectiveness, not on the preservation of existing programs and levels of spending. This approach requires that budgeting be directed at programs rather than at specific line items, that the goals of those programs be laid out in measurable terms, and that performance review becomes central to budget decisions."

Performance Budgeting is currently the hot topic in state budget development. It is beginning to turn up in various forms in several states, particularly the strategic planning aspect of this process, setting goals and objectives. The most difficult part of Performance Budgeting up to this point has been in identifying meaningful measurements of performance. It is easy to quantify workload; but much more difficult to measure quality which requires a context of public satisfaction, productivity, cost benefit, and fairness. The other two difficulties, once you have meaningful measurements in place are; how do you reward performance in the budget process and how do you sanction poor performance. Are State Legislatures expected to "hard code" budget decisions into a

performance budget process on automatic pilot and thus surrender oversight?

"Advocates contend that the difficulty of implementing a performance-based budget is evidence of how thoroughly state government needs to be reformed. They say that the difficulty of agreeing on goals for programs is evidence that the evidence that the issue has been neglected, and the process of trying to reach agreement will produce valuable analysis and debate. The difficulty of measuring performance has to be faced squarely. How else can anyone know whether government is providing needed services? How else can public confidence in government be rebuilt?"

E. Zero-Based Budgeting

Zero-Based Budgeting (ZBB) began in the private sector in a formal sense with Texas Instruments in the late sixties. The popularity of zero-base budgeting (ZBB) spread to state government in Georgia in the early seventies under then-Governor Jimmy Carter who then introduced it at the federal level with his election in 1976. The appeal of Zero-Based budgeting lies in its name mostly, and the expectations it creates. In its pure form the process actually does not work very well in the state budget process.

Basically, ZBB starts at point zero every year for all funding decisions. The budget, for all intents and purposes starts from scratch every year for both existing and proposed new programs. Individual programs and activities in a state agency are then prioritized in their importance, and from the ground up all of these units are considered as building blocks in the budget. The intent of ZBB is to take no previously funded programs for granted, requiring that every program emerge through a competitive looking glass which asks the question, what are the consequences of not funding this program?

"State programs are not, in practice, amenable to such radical annual re-examination. Statutes, obligations to local governments, requirements of the federal government, and other past decisions have many times created state funding commitments that are almost impossible to change very much in the short run. Education funding levels are determined in many states partly by state and federal judicial decisions and state constitutional provisions, as well as by statutes. Federal mandates require that state Medicaid funding meet a specific minimum level if Medicaid is to exist at all in a state. Federal law affects environmental program spending, and both state and federal courts help determine state spending on prisons. Much state spending, therefore, cannot usefully be subjected to the kind of fundamental re-examination that ZBB in its original form envisions. No state government has ever found this feasible. Even Georgia, where Governor Jimmy Carter introduced ZBB to state budgeting in 1971, employed a much modified form."

The positive aspects of ZBB for states that experimented with this very tough-minded process were that many programs for the first time received some close scrutiny. Secondly, the intent of this budget process survived in varying forms as many states adopted certain aspects of Zero Based Budgeting that worked within that particular state's existing process.

Examples of this include prioritizing new budget requests across programs within an agency, developing one-time expenditure policies or the "sun-setting" of certain programs, and developing alternative options or levels of funding for accomplishing a goal.