

Committee of the Whole

Agenda Cover Memorandum

Meeting Date: October 25, 2010

Item Title: Budget Policy

Action Requested:

- X Approval
For discussion
 Feedback requested
 For your information

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Background:

At the December 21, 2009 City Council meeting Mayor Schmidt asked that discussion of the City's budget policy be placed discussed at the Finance and Budget Committee of the Whole meeting. City Manager Hock reviewed zero-based budgeting and hybrids at the January 16, 2010 Budget meeting. As part of the Budget process, staff updated the City's Program Guide in order to provide detail on each of the City's programs and the cost to provide each service.

At the January 25, 2010 Committee of the Whole meeting, the Council asked that the City's current budget policy language be expanded to include more detailed parameters. There was discussion as to whether this detail should be added to Article 2 of the Municipal Code or instead to Council Policy Statement 17 "Budget Procedures". No decision was made at the meeting. The Council requested that this issue, along with draft language, be placed on the February 22, 2010 COW agenda for further discussion. The additional language was provided in the form of a revised Council Policy Statement #17.

At the February 22, 2010 COW meeting the Committee made additional modifications. Mayor Schmidt asked that the language be provided in ordinance form. This item was placed on the March 22, 2010 agenda for discussion and additional comments were made by the Mayor and City Council. The City Manager requested that this item be placed on hold until the City hires a new Finance Director.

Attached is the proposed ordinance form of the budget policy as discussed with modifications made at the last Finance & Budget COW meeting.

Recommendation:

Discuss and provide direction to staff.

Budget Implications:

Does Action Require an Expenditure of Funds: Yes No
If Yes, Total Cost:
If Yes, is this a Budgeted Item: Yes No

Attachments: Draft Ordinance
Zero Based Budget articles

ORDINANCE NO. _____
AN ORDINANCE OF THE CITY COUNCIL OF THE CITY OF PARK RIDGE
AMENDING ARTICLE 2, CHAPTER 9, SECTION 2
OF THE MUNICIPAL CODE OF PARK RIDGE

BE IT ORDAINED BY THE City Council of the City of Park Ridge, Cook County, Illinois, pursuant to its home rule authority provided under Article VII of the Illinois Constitution of 1970 as follows:

SECTION 1: That Article 2, "Corporate Seal, Emblems and Policies," Chapter 9, "Budget Policy," Section 2, entitled "Powers and Duties of City Manager in Implementing Budget Policy," Paragraph B of the Park Ridge Municipal Code is hereby amended to read in its entirety as follows:

B. Compile an annual budget in accordance with the following:

1. The City Manager shall submit a proposed balanced budget by February 1 each year, separating the base budget from new and major programs and revenue source changes.
2. The budget shall contain estimates of revenues available to the City for the fiscal year for which the budget is drafted, together with recommended expenditures for the City and all of the City's departments, commissions and boards. Revenue estimates and expenditure recommendations shall be presented in a manner, which is in conformity with good fiscal management practices. The budget shall contain actual or estimated revenue and expenditures for the two (2) years immediately preceding the fiscal year for which the budget is prepared, along with 1 year's future projection. Each budget shall show the specific fund from which each anticipated expenditure should be made.
3. ~~That being said, the proposed budget shall be balanced, with current revenues matching current expenditures. Proposed use of fund balance shall only be for one time expenditures, emergencies, or short term revenue shortfalls. If revenues are unable to match expenditures, the City Manager will outline what services will be reduced. proposals for a balanced budget.~~
4. New programs shall include major changes in service levels, increased services or deleted services.
5. Revenue source changes shall include any rate or fee schedule change, additions of new revenues, and deletions of revenue sources or other major financing policy issues.
6. Once the budget is approved, revenues and expenditures shall be monitored on a regular basis and adjustments made in spending if revenues are less than projected. The City Manager shall provide quarterly reports to the City Council. The City Council shall review and discuss on a ~~quarterly~~ **monthly** basis.

SECTION 2: This Ordinance shall be in full force and effect from and after its passage, approval and publication according to law.

SECTION 3: The City Clerk is hereby authorized and directed to publish said Ordinance in pamphlet form according to law.

CIPFA



ZERO BASED
BUDGETING

AT THE HEAD
PUBLIC SERVICES



The 2007 Comprehensive Spending Review will include a set of zero-based reviews of baseline expenditure in Government departments, aimed at assessing their effectiveness in delivering the Government's long-term objectives, and contributing further to the Efficiency Programme. Departments will need to identify elements of their DEL for these reviews. This note is intended to provide an introduction to the zero-based concept.

Zero Based Budgeting [ZBB] is an approach to budgeting that starts from the premise that no costs or activities should be factored into the plans for the coming budget period, just because they figured in the costs or activities for the current or previous periods. Rather, everything that is to be included in the budget must be considered and justified.

This initially appears to be a very resource hungry approach, and if applied in this simplistic form, would quickly fall foul of the law of diminishing returns. However, the application of practical common sense to the ZBB concept quickly identifies potential gains, and it will be seen that ZBB also aligns closely to current initiatives, including the Efficiency Agenda, and to performance measurement.

ZBB is not new – it first appeared in the 1960's – and indeed it is not surprising that dissatisfaction with a purely incremental approach to budgeting has been one of the main drivers in attempting to find budgeting models that actually serve the purposes and objectives of the organisation.

In its pure form, ZBB involves the preparation of operating budgets on the assumption that the organisation is starting out afresh in the new planning period – it is as if the life of the organisation exists as a series of fixed term contracts. However, it is usually used most effectively where the activities involved are wholly or mainly discretionary in nature. But it is very easy to fall into the trap of assuming that something is non-discretionary, for no other reason than the activity has been carrying on at a similar level for a number of years.

ZBB can be applied usefully to budget heads such as repairs, maintenance or equipment costs. The traditional incremental approach often pays scant attention to these heads, perhaps at best looking at trends over 2 or 3 years, and very often simply taking "last year plus x%". But it is often possible for service priorities to be proposed, discussed and established without reference to previous years. If proposals for resource allocations are presented with options for service level and predicted outcome, funds can then be allocated on the basis of best value for money. ZBB is there to question set assumptions, and to provide a tool for systematically reviewing, reprioritising, and perhaps withdrawing from long term activities that no longer align properly with an organisation's objectives.

Successful use of ZBB relies upon the effective involvement of all executive managers. Like all good budgeting processes, it requires that the organisation's objectives are determined and clearly stated. Where it differs from the traditional route, and adds value to the budget process is in the next stage, where different ways of achieving those objectives are explored and assessed, so that the resources associated with the preferred option can be actively justified.

Milestones in the introduction and implementation of ZBB

A – Developing Decision Packages

The "decision package" is a term associated with ZBB, and refers to an analysis of each discrete activity, according to cost and purpose. The analysis should also extend to considering the benefits of the activity, alternative courses of action, how to measure performance, and the consequences of not performing the activity.

Decision packages should relate to activities that are stand-alone; a good test is whether a decision could be made to sub-contract, or to abandon the activity altogether, without materially affecting the deliverability of another activity. This is a "could it be

done" question, rather than "should it be done". If such a decision could not be made, the activity is likely to be part of a larger decision package.

This milestone can be broken down further:

Stage 1 – Defining the Scope of ZBB

Decide which parts of the organisation are to be assessed using ZBB. For complex, multi-function organisations, it may be helpful to pilot the approach in a few areas where activities are closely aligned to organisational structure.

It is essential that the activities to be assessed have clearly defined objectives, and wherever possible, measurable outputs and outcomes.

Stage 2 – Identify the resources

This stage falls into 2 parts:

The identification of the schedule of input resources that will be required in order to deliver the outputs

The identification of the individuals who will take responsibility for assessing the various options.

Stage 3 – Objective matching stage

It is possible that objectives may be deliverable at different service levels, and in these cases, the review should identify, as a minimum:

- Basic level of service (usually, in a public sector context, that which is required to meet statutory duties)
- Current level of service
- Any step changes in service

Options for delivering each level may differ and will need to be identified. Clearly, it is essential to be able to analyse costs between fixed and variable elements.

B – Ranking the decision packages

The decision packages should be evaluated and ranked in order of importance. Performance

measurement tools including cost/benefit analysis are clearly a very important component, but it is also appropriate to apply a level of subjectivity. This is because few activities are capable of reduction to a manageable number of measures, while some ideal measures may not be practical because of difficulties in real world application, or simply because of the costs of data collection. For example, managers may believe that there would be a "feelgood" factor in taking a particular course of action. This could never be accurately quantified.

C – Allocating resources

The ranking list then results in a priority order for the allocation of resources. The most important

activities are funded, whether they are existing ones, or new. The final budget will be made up of the decision packages that have been approved for funding, reallocated into the appropriate operational units.

The Pros and Cons of ZBB

ZBB can offer a number of advantages when it is applied intelligently. As mentioned above, it is a potentially very useful tool in terms of the current Efficiency Agenda, and parallels much of the thinking that underlies this initiative, and the approach to the Spending Review process. Top management can expect to have available the detailed information that will enable decision-making, and that will highlight redundant activities or duplications of

effort within an organisation. The key benefit, though, is that ZBB serves to focus attention on the actual resources that are required in order to produce an output or outcome, rather than the percentage increase or decrease compared to the previous year. It is a practice which in fact should be more user friendly to operational managers than the traditional incremental budget model. It moves the process away from the bookkeeper's number crunching spreadsheets, and engenders a balanced partnership between the finance professionals and the budget holders in the analytical and decision-making processes.

The advantages and disadvantages of ZBB can be summarised quite concisely, as in the table below:

+	-
Questions accepted beliefs	Adds to the time and effort involved in budgeting
Focuses on value for money	May be difficulties in identifying suitable performance measures and decision criteria
Clear links between budgets and objectives	Questioning current practice can be seen as threatening – careful management of the "people" element is essential
Involves operational managers actively, and can lead to better communication and consensus	May be uncertainty about costs and resources of options other than current practice
Is an adaptive approach to changing circumstances	
Can lead to better resource allocation	

In practice, the balance can be optimised through:

- A phased introduction of ZBB, concentrating initially on less complex areas, in order to build up a foundation of skills and experience

- Containing the use of ZBB to activities that are truly discretionary
- Adapting the approach, so that it becomes a consideration of the impact on service delivery of step changes up or down in resource provision.

WHAT IS ZERO-BASE BUDGETING?

Zero-base Budgeting is a budgeting and financial management strategy to help policy makers achieve more cost-effective delivery of public services.

The concept of zero-base budgeting has been utilized successfully by private corporations and recommended for application to the federal budget for some time. For government use, this planning and budgeting technique endeavors to redirect effort and funds from lower priority current programs to higher priority new programs, improve efficiency and effectiveness, and reduce spending.

Traditionally, most government budgets have been constructed by adding to the current expenditure level such amounts as seem warranted by circumstances. In most jurisdictions, expenditures for the coming year will exceed those of the current year. For this reason, most attention is directed to the "increments" that have been added to this year's expenditures to reach the proposed budget total. A major flaw in incremental budgeting is that it assumes the current year's expenditure level is justifiable and this may not be true. It may be either too high or too low.

Zero-base budgeting, on the other hand, is a detailed and concentrated study of those activities that might be considered costly or ineffective and that continue to be funded primarily because they are never examined.

It may be useful for one or more government programs to be subjected to zero-base budget analysis every year. In such an analysis it is not assumed that the current year's spending for a particular program is justified. On the contrary, the wisdom of spending any money at all on the program is examined.

These questions are typical for analyses of this type:

- Is there any measurable evidence of the value of the program under review?
- Are the goals and objectives of the program important enough to warrant the expenditure being made?
- What would happen if the program were not provided at all?
- Are there other less costly and more effective ways of achieving these objectives?
- Where would the program fit in if all programs were displayed in order of importance?
- Would the benefits be greater if a portion of the funds spent on the program under review were used instead for other programs?

An important element of this budgeting procedure is that it forces prioritization of government programs and activities. With the prospect of insufficient revenue to match the demand for spending, it is useful for government to have a ranking of programs and activities based on proven effectiveness, as well as suggested alternatives to expensive or ineffective programs.

There are two basic steps to the process of zero-base budgeting. The first step is to develop what is referred to as "decision packages." The second is to rank the decision packages. The decision package is a document that identifies and explains the specific activity, its goals and objectives, measurement of performance, costs, benefits, and

alternative courses of action. Ranking of decision packages is then accomplished at each management level until a comprehensive agencywide ranking is obtained.

Conceptually, zero-base budgeting is a systematic logical approach to allocating limited resources where they will do the most good.

Modified Zero Based Budgeting

Service-level budgeting is a modified zero-base budgeting approach. This concept matches spending levels with services to be performed. Under zero-base budgeting, a great deal of effort can be devoted to documenting personnel and expense requirements that are readily accepted as necessary. Modified zero-base budgeting can avoid this by starting at a base that is higher than zero. An appropriate starting point for a jurisdiction might be 80 or 85 percent of current spending levels. High-priority requests above this level could be identified to restore part or all of the current year's service levels.

Desirable new programs could also be considered for funding. As a result, a legislative body might be presented the choice of reducing some current operations in favor of adopting a new program. Thus a new program might be funded out of savings incurred by reduction of an existing program. The phrase "service-level budgeting" is in some cases a better description for this process.