

Zero Based Budgeting

Presented To:	Finance and Administration Committee
Meeting Date:	September 21, 2021
Type:	Managers' Reports
Prepared by:	Liisa Lenz Financial Support & Budgeting
Recommended by:	General Manager of Corporate Services

Report Summary

This report responds to Council's direction to provide a report describing Zero Based Budgeting and the work required if the City chose to adopt this budgeting method.

Relationship to the Strategic Plan, Health Impact Assessment and Community Energy & Emissions Plan (CEEP)

This report refers to operational matters and has no direct connection to the Community Energy & Emissions Plan.

Financial Implications

There are no financial implications associated with this report.

Background

During the June 22, Finance and Administration Committee meeting, staff were directed to present a report describing Zero Based Budgeting and what would be required for the City to utilize this budgeting method. This report describes the City's current practices, describes Zero Based Budgeting, and the implications to the City to transition to this budget method.

What is Budgeting?

A budget is a plan that describes, in financial terms, expected service efforts for a defined period. It includes both the planned funding sources (ie. revenues) and resource requirements (ie. expenditures). Typically, although not always, a municipality's budget describes more than just planned financial cost. A municipal budget also provides important contextual information about its operating environment, planned activities and goals as well as prior year results.

There are several different methods used to prepare a budget, including:

Incremental Budgeting: The prior period budget becomes the starting point for adjustments made to reflect the changing environment and determine the current period budget. This approach anticipates planned

services and service levels are consistent between reporting periods.

Zero Based Budgeting: Using this approach, every budget line begins at zero for each new budget period. Each cost and revenue element is assessed to determine if it is still required for delivering the business plan. Services and service levels are reviewed and changes are considered to find a result that achieves desired financial objectives.

Service Level Budgeting: This approach begins with defining desired outputs and requires a comprehensive understanding of services and service levels, as well as the cost implications of planned service levels. Costs are determined after confirming planned service levels/outputs (“Services drive costs”).

Outcome Budgeting: This approach begins with a review of the broad outcomes anticipated in documents such as the strategic plan and evaluates the services, outputs and resources required to achieve them. Much like with service level budgeting, planned revenues and costs are determined based on the understanding of what is required to achieve the outcomes. A series of program evaluations is undertaken to assess results.

The City of Greater Sudbury’s Budget Process

Over the last five years the City has been developing a service-based budget process, emphasizing planned service levels and performance. Historically, it used an incremental budget process, with adjustments each year to reflect the prior period’s actual revenues and expenditures and focusing on line item adjustments.

The budget process begins with an assessment of the operating environment and service performance. Departments are instructed to first review their actual costs, contractual agreements, changes in legislation and operating environment to assess if current resources can sufficiently address planned service requirements in the upcoming period. At the same time, departments will also review their revenues, including third party funders, user fee rates and service utilization levels. This leads to adjustments that reflect actual prior period experience and keeps the budget from simply being an incremental change from the prior period. The objective is to provide Council with information that supports a discussion about whether, or how, to make adjustments to services, service levels or service delivery methods.

This approach is more comprehensive than incremental budgeting, since it requires an extensive awareness of service objectives, service levels, actual performance and resource requirements. It depends on effective collaboration between finance professionals and operational staff that have detailed understanding of services and cost drivers.

Zero-Based Budgeting

As described above, zero-based budgeting or ZBB is the approach to budgeting where all accounts start at zero at the beginning of each planning period. Resource requirements are assessed and confirmed with each budget, such that no service level or workflow is deemed to be outside an annual review to determine their continued need. Based on the results of such a review resource needs are costed to determine the expenditure budgets. The purpose of ZBB is to enhance the understanding of resources required to perform a task, their cost and their value-added in producing planned results.

This approach to using ZBB is extremely limited, primarily due to the significant resources required to prepare such a budget. However, examples exist of municipalities that use an adapted approach of ZBB to prepare part, or all of their annual budget.

The expectation is that a ZBB model presents several different options/budget packages for review that show the implications of maintaining expenditure levels and/or adjusting expenditures to meet anticipated requirements. This would include illustrating the implications of service reductions. Typically, different options are not provided and the focus is on reviewing accounts to evaluate whether resource levels can be justified by decision makers. This means departments use ZBB to thoroughly review the factors influencing resource levels and associated cost for continuing existing services.

The main advantage of ZBB is the insights it provides for a better understanding of the costs to provide services, and how best to allocate scarce financial resources. It enables clear choices about strategic priorities and which operations or services will be funded based on their perceived value. Another advantage is that the method allows departments to gain a firm understanding of the resources required to undertake their regular operations. These features of ZBB exist within the City of Greater Sudbury's current budget process.

There are also disadvantages with ZBB, primarily its focus on inputs and current operations rather than the outputs desired from service levels and an organization's longer-term strategies. ZBB is based on defining operational needs, which can create a disconnect between strategic documents such as Council's Strategic Plan, the Official Plan or other long range policy documents. Other drawbacks include the time and resources required to perform the budget on an annual basis. Typically the ZBB method requires more involvement by both management level and Council than other models to review all inputs and decision points.

Comparative Practices

The Government Finance Officers Association (GFOA) is an association that represents more than 20,000 public finance officials throughout Canada and the United States with the mission of advancing excellence in public finance. In 2011 GFOA published a study of ZBB. The study included a survey which indicated approximately 20% use ZBB, with the remaining survey respondents not adopting it after some investigation, or simply not considering its adoption. The primary reason for such a small uptake is due to the large amount of work and time required to perform this method of budgeting, and the concern that benefits may not outweigh the costs.

What would it take for CGS to Transition to Zero Based Budgeting?

The City of Greater Sudbury's current budget process incorporates the key benefits of ZBB and offers more information than ZBB provides. Requiring a ZBB approach would nonetheless incur more resource demands.

These resource demands would generally involve more staff time from service areas to document and assess the activities, define service levels and resource requirements to perform that activity. This would include introducing new steps as part of the annual budget development process to systematically identify the type of service adjustments Council would be willing to consider. This change from the current process would increase the scope of Council's budget deliberations and require more time to debate budget directions.

Unlike the current approach, which anticipates services and service levels remain generally consistent between budget periods (with exceptions noted and debated in the form of a Business Case), a ZBB process would assess the potential for change in each service. This level of analysis and preparation would require additional staff who have the requisite financial analysis skills needed to prepare documentation that would support Council's deliberations.

The corporation's current enterprise system does not support ZBB, so it would need to be replaced or augmented with some additional software if there was a desire to adopt a ZBB approach. Alternatively, the City can maintain the existing system and have more reliance on the use of spreadsheets to prepare and justify a ZBB, but this would not be efficient. Training for staff and Council would be developed to ensure a ZBB process was well understood and properly applied. The cost of this change requires further investigation.

From an operating perspective, the process of ZBB would require more staff time than the current budget process. This is the main drawback for almost all municipalities that have considered this method. Currently, staff invest approximately 12,000 hours to prepare the annual budget. Moving to a ZBB process would require approximately 18,000 hours, or approximately 6,000 hours more than the current process requires. Extra time is needed at all steps of the process, from developing, to reviewing, to preparing the final document. This is not just about dedicating more time, however. As noted, more analytical staff would be

required to support a ZBB process and to prepare the draft budget.

It should be noted that this does not reflect the time for operating departments to prepare their individual budget submissions. Based on what is involved in preparing a ZBB, it is anticipated that 50%-100% more time would be required putting additional pressures on operating departments to perform operations and provide services at Council approved levels. With the implementation of COMPASS, it will be better understood how much time is dedicated to the budget process as the time requirement varies throughout the organization. The additional time required of operating departments may not produce an incremental financial impact, but it would draw resources currently dedicated to supporting other elements of their services.

For Council's reference, in November 2011, the Finance Committee was presented with a Zero Base Budget report for the Summer Roads Maintenance program. This report highlighted the operating expenditures required to maintain all roads assets (roadway, sidewalk, curbs, gutters, catch basins, signs etc.). The analysis reflected the type of work and frequency using best maintenance practices described by the Ministry of Transportation.

This produced a recommended budget of \$18 million (at the time) for Summer Roads Maintenance. However the City's budget was \$13.8 million, a shortfall of \$4.2 million. The reason that the ZBB exercise resulted in such a large shortfall is because the method of budgeting at the time did not reflect the best practices for frequency of work required. For example, the base budget at the time accounted for the resurfacing of gravel roads every 80 years for an annual cost of \$257,000. The recommended service level called for resurfacing gravel roads every 20 years resulting in a budget requirement of \$1,075,000. This example allowed Council and staff to better understand the current summer roads maintenance program, as well as the recommended maintenance program, and the financial cost of each.

Staff have the ability to implement zero based budgeting if directed by Council, but we view the current approach as a more strategic and comprehensive process. Incorporating a program of zero-based reviews, like what was undertaken for a review of the Summer Roads Maintenance program, or like what has been done by the City of Calgary, could be introduced outside the budget process with appropriate resources.

Conclusion

Staff believe the current budget process is effective for the insights it provides into comparative performance, alignment with policies and strategies and for minimizing the administrative time required to produce a draft budget. Adopting a ZBB would increase the amount of administrative time required to produce the budget without incrementally greater benefits.

Resources Cited

Zero Based Budgeting: Modern Experiences and Current Perspectives GFOA

<https://www.gfoa.org/materials/zero-base-budgeting>

Budgeting Approaches for Municipalities: Municipal Finance Officers Association of Ontario

https://www.mfoa.on.ca/mfoa/main/pdfs/AC17_Tues_Sept19_Budgeting_Approaches_Dunbar_Collins.pdf

Summer Roads Maintenance – Zero Based Budget (Pg 5 – Pg 14)

<https://pub-greatersudbury.escribemeetings.com/FileStream.ashx?DocumentId=35546>