

PERFORMANCE-BASED BUDGETING METHODOLOGY AND TOOLS

W H I T E P A P E R



**LEARN HOW TO LINK YOUR BUDGET DECISIONS
WITH STRATEGIC OUTCOMES**

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In this time of economic instability, citizens want real-time updates on the financial decisions and budget allocations made by their local and state government officials. Unfortunately, traditional line-item (“black box”) budgeting can not accommodate this request, which has resulted in diminished credibility among concerned citizens who question how their tax dollars are benefiting the community.

To combat the shortcomings of line-item budgeting and increase understanding of how strategic goals are translated into dollars, local and state governments are implementing a more transparent budgeting system: performance-based budgeting (PBB).

In this white paper, you will learn the ins and outs of this cutting edge practice in budget development and be able to answer the following PBB fundamental questions:

- WHAT IS PERFORMANCE-BASED BUDGETING (PBB)?
- HOW DOES PBB LINK BUDGETS TO RESULTS?
- WHAT ARE THE MAIN BENEFITS OF PBB?
- WHAT ARE THE MAIN DRIVERS TO PBB ADOPTION?
- WHAT ARE MATURITY LEVELS IN PBB?
- HOW CAN A SOFTWARE TOOL HELP?



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WHAT IS PERFORMANCE-BASED BUDGETING?

Performance-based budgeting, also referred to as outcome budgeting, is the practice of developing budgets based on the relationship between funding and expected results. In doing so, PBB improves cost-efficiency and manages effective budgeting outlays, increasing visibility into how government policies translate into spending and making systematic use of performance information.

It is important to understand the key components of performance budgeting: inputs, outputs and expected outcomes. In the performance information chain, inputs (resources) link to outcomes (macro goals) via change from the goods or services of those outputs (deliverables).

INPUTS → OUTPUTS → OUTCOMES

A linkage between inputs and outcomes can be created for the majority of outputs produced by an organization; however, outputs affected by external factors (i.e. weather, economy, social make-up of the group, etc.) can hinder or eliminate the ability to develop a close linkage.

HOW DOES PBB LINK BUDGETS TO RESULTS?

Linking budgets to results is a difficult task with three steps:

STEP ONE: Identification of a complete set of performance measures or indicators to help objectively evaluate program performance.

There are three main types of output indicators: indicators of output quantity, indicators of output quality, and indicators of efficiency.

Output quantity indicators measure the volume of service provided. Output quality indicators provide information on the extent to which the service or activity is likely to achieve its intended outcome. Some quality indicators are easier to measure objectively than others.

For example, timeliness could be measured by the average time to complete a process, (i.e. the average time to

process a license application) while others, like satisfaction with a service, can only be measured by collecting data from a supplemental data source (i.e. a customer survey.)

Another approach in measuring quality indicators is a discussion-based approach, where all affected stakeholders cast subjective opinions that are tallied up and evaluated for efficiency. There is a great need to focus on quality measures, as often the most popular way of cutting costs is by reducing quality.

STEP TWO: Once the set of performance measures has been identified, the next step is determining which organizational units contribute to activities and how to allocate those activities to the corresponding programs. Sometimes the allocations are straightforward, especially when all operating unit costs are directly allocated to the cost of the program or sub-program.

The allocation of indirect costs is less straightforward. For example, the costs of administrative units, such as purchasing and finance, need to be allocated to programs.

Among the more sophisticated indirect cost allocation methods is Activity Based Costing (ABC).

ACTIVITY BASED COSTING (ABC)

This method collects cost in functional activity cost pools (group of individual costs that is allocated to cost objectives using a single cost driver) and then applies costs to products/services using individual cost drivers. ABC's objective is to eliminate any activities that do not add to the service provided and with this, costs can be reduced without compromising the service offered to the customers. ABC can help organizations understand the cost and value of service activities, which is essential to control escalating operational costs. ABC capability requires an internal managerial accounting expertise and a powerful ABC software system.

Another complex element is not only to be able to perform the initial allocation for budgeting purposes, but also to keep track of the actual expenditures by program. This can only be achieved by capturing actual

WHITE PAPER

hours or expenses systematically via tagging activity/program related elements in time management, purchasing, contracts and other related systems.

STEP THREE: The final step in the PBB process is to develop a Program Evaluation Process (PEP), a framework that allows the organization to effectively prioritize and score program budgets during the budget cycles and conduct periodic performance reviews during the year's budget execution phases.

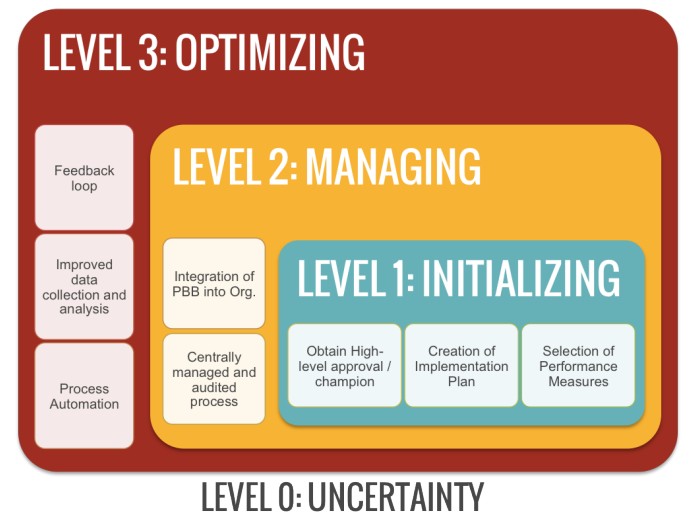
PBB MATURITY LEVELS

Organizations have a number of PBB best practices and approaches at their disposal, but rarely will they achieve a mature level all at once because implementing PBB is a process rather than an event. This process can be measured on a maturity level scale of 0–3, along which organizations will achieve differing PBB capabilities. Depending on how quickly an organization advances through the maturity levels, it will either institute stringent, light, or no disciplines.

LEVEL 0: UNCERTAINTY In this stage, there is a lack of organizational awareness, commitment and structure regarding PBB requirements and processes. The organization lacks a formal sponsorship and approval from senior leadership to initiate and implement an organization-wide PBB framework. Any existing or past PBB effort is likely the result of a few individuals, and it cannot be replicated because of insufficiently defined and documented processes.

LEVEL 1: INITIALIZING In the first maturity level, senior leadership grants high-level approval and direction to initiate a PBB process. A formal organizational structure, including roles, responsibilities and an implementation plan is being defined. There is a focused effort to conceptualize the PBB framework, and develop a strategic plan that includes identifiable performance objectives, performance measures, linkages and outcomes.

At this point, the organization also assesses the required business and technical capabilities (i.e. creating robust set of performance measures; developing a tool to record and maintain performance data; modifying a GL structure to capture program/service level information; etc.) and formulates an implementation plan to enable the required capabilities.



LEVEL 2: MANAGING The second maturity level is achieving full integration of a PBB framework into business operations and managing the PBB process. There is a formal organizational structure in place to manage PBB. The organization is fully aware of the business and systems issues in managing the PBB framework, including processes, documentation, integration practices, standards and deliverables. The PBB process is being centrally managed and routinely audited through data collection and analysis.

LEVEL 3: OPTIMIZING Finally, it is important for the organization to recognize that PBB, like any other organization processes and frameworks, needs continuous improvement. This maturity level requires that the organization is focused on perpetual optimization of the PBB process through feedback and monitoring of the current capability with an attempt to advance it through pro-

WHITE PAPER

cess optimization, improved data collection and analysis, and finally automation. Additionally, there must be a certain amount of acknowledged responsibility (and wisdom) on the part of the organization for having a future oriented perspective to proactively optimize PBB components (people, process, technology) to be able to respond to the ever-changing business and technology landscape.

Once all the success factors are in place, the result can be a best-in-class PBB system that delivers substantive benefits and expected results.

WHAT ARE THE MAIN BENEFITS OF PBB?

There is no single model of PBB that works for everyone. To be effective, the PBB needs to be tailored to the needs of each organization, incorporating any unique processes and industry-specific best practices while maintaining the core tenets of PBB.

The benefits of implementing PBB are multi-fold:

- **Compliance**
- **Accountability**
- **Transparency**
- **Efficiency savings**
- **Improved services to citizens**

The Government Performance and Result Act (GPRA) requires agencies to establish a strategic plan and annual performance plan containing quantifiable performance goals for each program activity in the agency's budget. GPRA mandates a Chief Operating Officer (COO) in each agency who is responsible for improving the agency's management and performance, and the designation of a performance improvement officer in each agency who advises and supports the agency head and chief operating officer on performance management and improvement.

Additionally, state and municipal-level legislation is forc-

ing organizations to provide increased accountability and transparency to both internal and external stakeholders. Government organizations need to show the public visible results from budget objectives and the mechanisms for how they achieved, or did not achieve, those results. This need is highlighted in a report by the state of Wisconsin regarding "the difficulty measuring government's performance, about diverse and contradictory objectives, unreliable measurement tools, and a lack of resources call for a system to improve efficiency, effectiveness, and accountability."¹

A formal performance measurement program is increasingly becoming an important management tool to provide a method of evaluating programs, ensuring that funding is spent in a cost-effective manner, and providing a method for understandable accountability to the citizens.

Not only legal mandates, but also tough economic times call for accuracy, better controls, and greater visibility into costs, resources, and performance. As a result, many government agencies are pursuing aggressive efforts to restructure budgets in order to reduce spending and to better align budget resources with performance. To add to this challenge, organizations are also being asked to improve the efficiencies of their programs without reducing their effectiveness. PBB can greatly aid in the budget restructuring process.

WHO BENEFITS FROM A PBB SYSTEM?

POLICY MAKERS PBB provides tools to objectively evaluate and prioritize funding requests based on outcomes and service levels, as well as to justify allocating funding in support of organizational strategies and critical programs, from low performing to high performing program activities.

FISCAL ADMINISTRATORS PBB is collaborative in nature, helping to promote coordination and cooperation between agencies and departments, making inefficiencies easier to spot and correct.



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CITIZENS PBB promotes transparency and increases understanding of how strategic goals are translated into dollars. Citizens can see how their money is being spent.

HOW CAN A SOFTWARE TOOL HELP?

Once an organization achieves significant size or complexity, the traditional spreadsheet approach is no longer sufficient to deliver enterprise budgeting, reporting and performance management. Embedded inconsistencies with each spreadsheet creator multiply with every ad hoc request from managers, colleagues, and vendors. Versions circulating via email often delay or misstate quarterly or year-end results. According to Rajalingham, Chadwick & Knight (2000), a study from Pricewaterhouse Coopers found that significant errors plague 90% of spreadsheets used in corporate planning.

Modern generation software tools not only automate and streamline traditional budgeting processes, but also help unite cost-based budgeting with performance-based goals. Such software tools contain best practice frameworks that can be immediately leveraged by the organization.

These best practice frameworks, however, could be tweaked to accommodate the unique requirements of the organization, since, as we established earlier, there is no one single framework that fits all organizations.

The benefits of implementing such a performance-based budgeting software tool are multi-fold: decision makers

reach better long- and short-term budget decisions; stakeholders see more visible performance measures, timelier information, and easier identification of actual strategic priorities; and, in the process, organizations build more solid growth models, flag variances between costs and expected outcomes, improve auditability, and foster collaboration.

To maximize these benefits, organizations need to implement a software tool with four main components:

- The first component, the traditional budgeting process component, supplies the means and discipline to allocate and assign money, show variances, and create monthly or long-term forecasts.
- The second component is the performance-based budget process enablement. That's shorthand for linking key performance measures with the budgeting process and ultimately creating a common language and culture with shared perspectives.
- Real-time activity monitoring supplies a third infrastructure component. As actions are taken and money is spent, results are tabulated that show the economic effects of those actions.
- The last component is presentation. To help internal and external stakeholders understand and manage the results of the PBB process, the software tool must feature a rich and robust set of dashboards, all seamlessly integrated and easily deployable.

ABOUT NEUBRAIN

Neubrain delivers advanced budgeting, performance-based budgeting, performance management and business intelligence solutions to government organizations as well as Global 5000 enterprises and mid-market companies

Neubrain accommodates every client not only with the best in class solutions, but with full support, training, and use of best practices to fulfill all needs to analyze, budget, forecast, measure and report. Neubrain's industry-specific budgeting solutions include:

- Retailers (fashion, multi-chain, cross channel, on-line, etc.)
- Hospitality (restaurant and hotel chains, travel and transportation)
- Manufacturing companies
- Supply chain and distribution
- Federal government and Department of Defense
- State & local government
- Government contractors
- Education institutions and non-for-profit organizations

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