# The Challenges and Promise
## OF PROGRAM BUDGETING

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There are many reasons to consider adopting program budgeting,[1] but perhaps the most important is its ability to create a more transparent budget. A program budget shows exactly what the government does and how much it costs.

A program budget is meaningful to the governing board and the public because programs are directly relevant to how they experience public services. A program budget is organized into service areas, rather than just departments, objects of expenditure, and line items.

Budget discussions about police patrols and tree services, for example, are more meaningful than discussions about salary, benefit, commodity, and contractual service costs in the budgets of the police and public works departments. Program budgets also clarify trade-offs between different spending options. When there are no new revenues, if the budget for police patrols is to be increased, then the budget of another program, like tree services, will need to be reduced.[2] (See Exhibit 1 for a summary of the benefits of program budgeting.)

## CREATING A PROGRAM INVENTORY

The first step in program budgeting is to create an inventory of all the jurisdiction's programs. This clarifies exactly what the government does. Consider the analogy of a menu at a restaurant. If a menu had just five words printed on it — appetizer, salad, entrée, desert, beverage — the customer would have a difficult time understanding what was being offered and whether or not they might like the restaurant. Now imagine that the restaurant provides a long list all of the ingredients and recipes it uses. The customer would have access to a lot more information about what goes on at this restaurant, but would still have trouble deciding if they would like to eat there. Similarly, in a local government budget, information presented in the broad categories of "Police Department" or "Public Works Department" doesn't give citizens a good understanding of what the government actually does, and line items provide too much detail. This means that participants in the budget process have difficulty communicating and citizens can't see how their tax dollars are being used because they can't get a true understanding of all of the ser-

vices the government provides. In the way that a restaurant's menu summarizes the dishes offered (i.e., describes the results produced by the restaurant's recipes). A program describes a set of related activities or tasks intended to produce a desired result for constituents.

How, then, does a government identify the programs it offers? Generally, a program is broader than a line item or task, but more detailed than a department or entire function. Governments will want to identify programs that provide a discrete service that leads to an identifiable result or benefit.

There are also some general guidelines on what a program is not. Programs are not the same as facilities or locations. A recreation center, airport or golf course is a place, while a program is intended to tell us the activities that go on at that place. Nor are programs line items or operational units found on your organizational chart. Line items are the costs that a program incurs. Operational units are management structures that administer a program.

The following questions can help you help identify programs.

*Do you advertise a service?* If your webpage, brochures, telephone directory, or other published materials say that you offer a service, it is probably a program to include in your program inventory. Advertisements are the first place to look when preparing an inventory of programs.

*Are you mandated to provide the service?* If there is a legislative mandate from another government, a section of your own code, or an official policy that requires you to provide a specific service, include it in your inventory.

*Is someone willing to pay a fee or offer a grant to provide the service?* If the end user of a service or a granting agency is willing to cover the cost of providing a program (in whole or in part), include it in your program inventory.

*Do you offer the service to a particular group or demographic?* If the program is meant to serve a specific constituency (e.g., residents, businesses, visitors, neighborhoods) or population (e.g., youth, adults, seniors, non-residents), list it.

*Is there a public agency or a private sector business that does something similar?* Governments have options for providing

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services, including partnerships, shared services, outsourcing or privatization. Hence, it is critical that we can articulate where services are similar to what is available from other providers and where they are different. Clearly identifying programs where there are alternatives to traditional service delivery strategies can better ensure that conversations are supported with objective data and not subjective assumptions.

A wide and diverse variety of services are provided even in the smallest of communities. Hence, to clearly tell the story of what your government does, you may need to identify hundreds of programs. In fact, most moderate-sized local governments should anticipate having 300 to 500 programs, and larger jurisdictions, especially counties, may have even more.

**Naming Your Programs**

A local government's program inventory should be descriptive, not opaque or mysterious. Names should be concise and easy to understand. Avoid unfamiliar abbreviations and acronyms.

## SIX STEPS OF PROGRAM COSTING

**Step 1: Distinguish between Recurring and Non-Recurring Costs.** The first step is to categorize each line item as a recurring or non-recurring cost. Examples of recurring costs are salaries, benefits, insurance, office supplies, and materials. One-time costs might include capital improvements and special projects. Differentiating between these two categories allows us estimate a reliable baseline cost for a program. Including one-time costs could inflate the perceived cost of a program above what it has been historically.

**Step 2: Distinguish between Personnel and Non-Personnel Costs.** Next, line items are further categorized as personnel-related versus non-personnel costs. Any cost that is directly associated with an employee (e.g., salaries, health care benefits, pensions) is a personnel cost. Because personnel comprise the vast majority of the cost for most government services, just estimating the full cost of the personnel that provide the service will go a long way toward accurately estimating program costs.

**Step 3: Associate Personnel with the Program they Provide.** Since people are the largest cost for most programs, the next step is to link each person (or position) with the program they support. An individual might support multiple programs throughout the year, so positions could be divided across more than one program. Most organizations do not have records describing how employees allocate their time to different programs. A simple survey of the employee or the employee's direct supervisor can be sufficient to get a serviceable estimate.

**Step 4: Allocate Non-Personnel Costs to Programs.** Non-personnel costs, like equipment usage, facilities, and information technology, are usually a relatively minor component of total program costs. Therefore, we don't want to use overly elaborate methods of allocating non-personnel costs. In some cases, allocating costs by the number of employees in a program might be good enough. In other cases, another cost allocation method might be better. Again, the allocation method should bear some relation to the actual resources consumed by the program, as well as being transparent and generally regarded as fair.

**Step 6: Associate Revenues with Programs.** After determining the costs of a program, an optional (and potentially powerful) step is to make the connection between the program and revenues generated directly by its activities, such as charges for services and grants. One of the greatest benefits of program budgeting is to enable conversations about the true cost of providing a service. Taking the revenues into account enables conversations about the true cost of providing service—i.e., the net of the revenues it generates. This perspective is important because costs that are not covered by

a program's revenues must be covered by general purpose revenues such as taxes. Because there is a firm practical, if not legal, limit to the general purpose revenue a government can raise, a program's ability to supports its own operations through other sources of revenue is an important consideration.

## COMMON CHALLENGES

Public managers have a number of valid reasons for being skeptical or even resistant to program budgeting. It is a fairly significant shift for many governments and can present both technical and political obstacles that the government will have to overcome. The following are examples of areas that can be difficult for some governments.

**Accommodating Programs in Accounting Structure.** For governments that want to do program accounting, program costs need to be captured using the organization's chart of accounts. But changing the chart of accounts can be difficult, costly, or nearly impossible for some organizations, given the constraints of their financial systems. Similarly, many organizations may not want to make changes to the chart of accounts until the program inventory is more fully established.

The solution to this concern is to forgo changing the financial system to accommodate program accounting and, instead, start tracking program costs (and budgets) using spreadsheets. Spreadsheet analysis can also be supplemented by more specialized software applications that exist outside of the financial system. Either method can eliminate the cost and risk associated with modifying the financial system, and neither requires departments to put in extra effort to track precise program costs. Spreadsheets and/or web-based applications could be used to pilot test program budgeting before investing time and money in more elaborate administrative techniques.

**Allocating Costs.** The second technical concern is gaining agreement on the cost allocation techniques used. Program budgeting requires a policy on how the cost — usually the full cost — of a program is measured, meaning that all of the

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resources used to provide a service to the public should be included in the cost of a program. For example, including the cost of the fringe benefits earned by employees, like pension and health care, in a program's cost should be uncontroversial. However, there might be disagreement about whether to include the cost of support services such as information technology, fleet, and facilities within programs or to classify them as programs themselves.

The way to address concerns about how costs for internal services are allocated is to use a method that is transparent, reflects some relationship between the services used and the costs incurred, and is perceived as fair. (For more information on allocating the costs of internal services, see the GFOA best practice, *Pricing Internal Services*.[3])

**Making Difficult Decisions Transparent.** Program budgeting invites participants in the budget process to make judgements about the relative value of services and to allocate resources accordingly. Some stakeholders may be concerned that their programs will lose funding. This concern can be addressed by clearly identifying the value of each project, along with the cost, and explaining why resources are allocated as they have been. This is a principle feature of program budgeting.

## APPLICATIONS

As we have seen, the technical procedures for determining and costing your programs do not have to be difficult. However, program budgeting can lead to difficult and controversial conversations about sourcing, developing fees and charges, and even cutting services. These must be handled with care.

Local governments that have used program budgeting to make important conversations possible include the City of Cincinnati, Ohio. Confronted with flat or declining revenues, spiraling health-care and pension costs, persistent structural imbalances, and a $34 million deficit, the city chose priority-driven budgeting as an alternative to its traditional approach, incremental budgeting (which automatically makes this

year's budget the basis for next year's spending plan). A primary goal was to engage a large and diverse segment of the community, creating an open and transparent window into every program and service offered, a thorough description of each service, and complete openness as to the cost of each program. Cincinnati's elected officials believed that the very legitimacy of their plan to identify $34 million worth of savings depended on an authentic attempt to offer citizens a clear perspective on how resources were currently allocated. Ultimately, the city identified more than 500 programs, totaling $972 million dollars. To achieve its objective of transparency, the city posted its program inventory, complete with program costs, on its website and in its budget document. The response from citizens was resoundingly positive; they appreciated this unprecedented level of transparency.

The same method also works for smaller governments. The City of Shawnee, Kansas, which is about a fifth the size of Cincinnati, used priority-driven budgeting to develop a program inventory and budget in order to reassess spending and ensure sound long-term funding decisions. As in Cincinnati, city leaders were intent on extending information to citizens and thus opening up a dialogue about the full breadth and scope of services the city offered, as well as the cost of these services. Shawnee built an interactive online tool that allowed citizens to look at data from each of the city's departments down to the division level, and ultimately down to a program level, to see what every program offered.

Cincinnati and Shawnee had similar objectives for undertaking program budgeting. The largest full-service fully accredited public safety agency in the United States, the $700 million Broward County Sheriff's Office (BSO) in south Florida, had a different objective. BSO provides full–time law enforcement services in 14 Broward County cities and towns. As the local economy tightened, the leadership among several of the cities came together to raise an important question: Are we getting a fair deal for the services we pay for from the county, or would we be better off forming our own local law-enforcement agencies?

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Program budgeting was key to this analysis. The county, along with the towns and cities, came to the table with shared objectives of being fair and transparently analyzing their service contract. They agreed to a way of costing each program that ultimately decreased the county's overall cost of services while also increasing trust and satisfaction from the cities.

## CONCLUSIONS

Many finance officers will have spent their careers delving into the kinds of controversial discussions that frequently polarize decision makers — whether or not to outsource, insource, raise fees, lower taxes, privatize, form a partnership, or divest the organization of a service. We in the field of public budgeting are attracted to these conversations not because we're crazy, but because the answers to these questions are so important to get right. Program budgeting provides a methodology and set of tools that are specifically designed to help resolve these kinds of debates by removing the ambiguity around what government actually does and what it costs. We encourage you to use this article and this issue of *Government Financial Review* to start a conversation in your government about program budgeting, what it can do for the community, and how you can put program budgeting into practice for a reasonable cost while making the most positive impact. ▌

**Notes**

1. The National Advisory Council on State and Local Budgeting makes program budgeting a lynchpin of its recommending budgeting practices. See the organization's *Recommended Budget Practices: A Framework for Improved State and Local Government Budgeting*, Government Finance Officers Association, 1998.

2. Example adopted from: Robert L. Bland and Irene S. Rubin, *Budgeting: A Guide for Local Governments*, International City/County Management Association, 1997.

3. GFOA's best practices are available at www.gfoa.org..

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