



TESTIMONY BY KALBERT K. YOUNG
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
STATE OF HAWAII
TO THE SENATE COMMITTEE ON WAYS AND MEANS
ON
SENATE BILL NO. 2276

January 29, 2014

RELATING TO STATE FINANCIAL ADMINISTRATION

Senate Bill No. 2276 amends Chapter 37, HRS, to incorporate zero-based budgeting (ZBB) principles into the State's current Program Planning and Budgeting (PPB) System. The bill requires that departments justify each program presumably every biennium (the amendments are not very clear whether justifications are required every biennium or every fiscal year) under the assumption that there are no authorized funds for the program. These justifications are required to include descriptions of:

- How the program fulfills the goals and objectives of the agency implementing the program; and
- Each specific activity of the program required to fulfill the goals and objectives, the number of personnel required to conduct each activity, and the cost of each activity.

The bill specifies that the new justification requirements are applicable to biennial budgets starting with FB 2015-17.

The Department of Budget and Finance has serious concerns with the long-term sustainability of requiring a ZBB-type review of every program, every biennium. Based on our research of other states' experiences with ZBB and the department's previous experiences conducting somewhat comparable program reviews, one of the biggest challenges is the sheer intensity of the workload and information gathering associated

with a ZBB-type review. Zero-based budgeting is an extremely time- and resource-consuming process for business-line operations and for policy decision-makers. Constructing a budget already requires departments to prepare and submit justifications for new-initiatives, additions, revisions-to-base, and a number of other aspects in the current budgeting process. This process from beginning to end already consumes no less than four calendar months - and, this does not include the deliberative period of the legislative session that also takes no less than four months to conclude on a budget. That means that the State of Hawaii already spends two-thirds of the year in the budget construction and approval process.

The current process does incorporate some of the tenants and philosophies of zero-based budgeting: Expenditures above the base are justified (albeit in their inaugural year), the Executive and the Legislature can review any expenditure in the base at its discretion, and budgets are already deliberated for methods of funding, positions, position status, and program objectives. To implement a true ZBB-type budget, operations in the Executive branch as well as the Legislative branch will be required to review, scrutinize, analyze, and decide on all the information and justification for every single program in the State. Frankly, given the limited duration of the legislative session and the demonstrated attention and diligence to the construction of past budgets by the Legislature, I do not believe the Legislature is well-equipped, positioned, or resourced to support a true zero-based budgeting process.

For example, Massachusetts formed a commission to look into the desirability and feasibility of adopting a ZBB system in 2012 and this was their conclusion (see attached Report of the Zero-Based Budget Commission, Commonwealth of Massachusetts, February 1, 2013):

“. . . Adopting a comprehensive zero-based approach for budget development was not a desirable, feasible or sustainable course of action for the Commonwealth of Massachusetts. This conclusion is based on the Commission’s understanding that, while many other states have tried to adopt zero-based budgeting, it often proved ineffective and generally was unsustainable on a comprehensive basis. The Commission further concluded that many states have found that a program-based approach, combined with the use of realistic and appropriate performance measures, has improved budget decision-making, as well as transparency and public accountability. It also concluded that such an approach could enable the strategic and effective use of in-depth reviews of select program’s performance and finances, and that such reviews would be consistent with best elements of so-called “zero-based” models adopted in other states.”

Finally, the National Conference of State Legislatures prepared a briefing paper on ZBB and this was their concluding “lessons learned” statement (see attached NCSL Fiscal Brief: Zero-Base Budgeting in the States, January 2012):

“Disadvantages aside, zero-base budgeting appeals to a serious and widespread desire to look at public budgeting in a fresh new way, free of old assumptions, not letting past experiences control the future. So, what can be learned from the kinds of experiences related here?

- A proposal to adopt zero-base budgeting should be clear on whether it is expected to be an analysis of all government, a tool to respond to a fiscal crisis, or a periodic, revolving review of state agency operations and budgets.
- In any of its forms, zero-base budgeting is likely to be an elaborate and time-consuming process, and can add complexity to the current budget process.
- Continued commitment from leadership and a commitment of time for legislators immediately involved are essential to make it useful to a legislature.”

Attachments



NATIONAL CONFERENCE
of STATE LEGISLATURES

The Forum for America's Ideas

NCSL FISCAL BRIEF: ZERO-BASE BUDGETING IN THE STATES

*Ronald Snell
National Conference of State Legislatures
January 2012*

Zero-base budgeting (ZBB) is a term currently used to describe a couple of methods of budgeting. Originally, however, it was used specifically to describe a system of budgeting that begins every budget cycle at zero, rejecting any assumption that the activities that were funded in the last budget will continue in the coming one. It requires a rationale for each activity that will be funded in the new budget. It was intended to foster thorough analysis and prioritization of every program and activity, with an emphasis on cost-effectiveness and economy.

Businesses first began using zero-base budgeting in the early 1970s. Jimmy Carter—its first prominent public sector advocate—started promoting it in the mid-1970s, as governor of Georgia and then as president. By 1978, the federal Office of Management and Budget had developed detailed procedures for using the method for developing the federal budget.

Proponents believed zero-base budgeting would:

- Eliminate the assumption that current activities and funding would automatically continue with only minor (or incremental) changes by forcing reconsideration of every activity and demand for resources.
- Encourage the termination of ineffective programs, through its emphasis on analysis and comparison of programs.
- Reallocate resources from lower priority programs or activities to those with higher importance.

- Improve managers' skills at all levels, enrich their communications with policymakers and foster discussion of key issues and problems.¹

Modified forms of zero-base budgeting have seen widespread use in state and local governments, but no state has used any one form for an extended period of time. The modified forms in use today are:

- **Alternative budgeting**, which requires agencies to make budget requests at various levels below and above their current level, along with comparisons of the consequences of each level.
- **Periodic agency review budgeting**, which requires each agency—over a number of years, usually five to eight—to review, from the ground up, their budgets, responsibilities, strategies and performance.

1. The Original Form

Zero-base budgeting was designed to control expenditures by identifying the purposes and measuring the effectiveness and efficiency of all activities. The form the federal government used in the late 1970s required these steps:²

- Identify logical “decision units” within an agency’s budget, which are programs, activities or organizational entities small enough for good analysis, but not so numerous that altogether they would overwhelm the budgeting process.
- Create a “decision package” for each decision unit that included: statements of intended agency results, preferably quantified; measures of workload, efficiency and effectiveness; and budget requests. The package comprised four funding levels:
 - ✓ The minimum amount necessary for viability;
 - ✓ The current or maintenance level;
 - ✓ An intermediate amount, between the minimum and current levels; and
 - ✓ An increased level to provide additional services.
- Rank decision packages within each manager’s jurisdiction according to policy directives from the manager’s supervisors.
- Advance decision packages up the administrative chain for additional review, prioritization, revision, consolidation or deletion.
- Consolidate the decision packages for budget requests.

The process the federal government actually put in place was paper-intensive (in the pre-computer days of the late 1970s) and relatively light in critical analysis. In

1979, the U.S. Government Accounting Office found little evidence that zero-base budgeting had improved the process. It recommended less paperwork and rigidity, fewer decision packages and funding options, and more analysis. The Reagan administration, which succeeded the Carter administration in 1981, preserved some elements of zero-base budgeting as agency budgets were reduced, such as requiring alternative funding options from agencies and focusing on prioritization of activities.³

The original form of zero-base budgeting from the 1970s, however, has been widely criticized as unworkable. Even the advantages President Carter claimed it brought to Georgia appear to have been exaggerated. The method's focus on decision packages was impossible to assimilate into the state budget process, and its techniques were impractical for allocating resources. Federal efforts have been termed "an exercise in futility."⁴ Some of the criticisms are that the process can:

- Be difficult to apply usefully to entitlement programs and to other continuing functions of government like public education.
- Create extreme competition and conflict among and within agencies over resource allocation.
- Be time consuming and expensive.⁵

2. Alternative Budgeting

By the early 1980s, use of the original form of zero-base budgeting had all but disappeared. States had developed a simplified form of it to address the fiscal difficulties of the time, which omitted decision units, decision packages and the numerous rankings required as the process moved through agencies.

States turned the old system into what is now called *alternative budgeting* (also called *target budgeting*), in which agencies make budget requests at various percentages of their previous funding—for example, at 90 percent, 100 percent and 110 percent—and analyze what effects those levels would have on their programs.

This highly simplified version of the old zero-base budgeting was widespread in state budgeting at the time. Since it was not a radical departure from traditional state budget processes, it was found to be a useful tool when budgets had to be cut or resources reallocated from agency to agency. The nominal link to zero-base budgeting gave alternative budgeting prestige, without requiring difficult or extensive changes in well-established procedures. It eliminated the numerous rankings that had been a major feature (and encumbrance) of the original federal version, so it did not greatly increase bureaucratic work. In practice, alternative

budgeting was used mainly to evaluate the ways agencies and programs would adapt to fewer resources.

What had started out as a state model of zero-base budgeting had evolved into a form of budgeting probably as old as budgeting itself—the consideration of alternatives. Whatever it may be called, this is (and always has been) a fundamental responsibility of executive and legislative budgeting. For a time it was formalized with specific levels of alternative proposals and given the name of zero-base budgeting, but the useful practice continues even without the name.⁶

3. Periodic Agency Review

State governments found it impossible to adapt to a budgeting process that required annual or biennial justification of every activity and program. They do not have the time or resources to apply a zero-base budget to subsidies for school districts or Medicaid support, for example. The apparatus of ZBB involved so many layers of description, analysis and recommendations that even the smallest state governments—let alone those with annual spending of \$50 billion, \$60 billion or \$70 billion—found it unwieldy. The required analysis was just too time-consuming for agencies, legislative staff and legislators.

For those reasons, most recent efforts to adopt some form of zero-base budgeting in state governments have called for a four- to eight-year periodic, rather than annual, analysis of state agencies.

Florida was one of the first states to enact an eight-year cycle of agency reviews in 2000. The Florida legislation established a joint legislative-executive process for when the Legislature was not in session. In 2001, legislators and teams of analysts from the House, the Senate, the Legislature's program analysis agency and the executive budget agency began a fundamental examination of each of the scheduled agencies. Although Florida's experiment with this form of zero-base budgeting produced reports of great thoroughness and usefulness, the process was expensive and time-consuming, and was discontinued after the third round of reviews.

Oklahoma lawmakers also adapted a periodic review process under legislation passed in 2003 that required a four-year cycle of zero-base legislative reviews of state budgets. The Oklahoma process was driven legislatively, in keeping with the state's strong legislature/weak governor approach to budgeting. The legislation directed a joint interim committee to conduct the ground-up reviews of state agencies, assisted by fiscal staff from both chambers.

The Department of Education, which distributes and oversees aid to school districts, was one of the first agencies to be reviewed. The process was valuable, but so time-consuming legislators never reached the point of considering the budget. Since that time, the Legislature has replaced its periodic review version of zero-base budgeting with performance budgeting.

4. Zero-Base Reviews in Action in Idaho and New Hampshire

Although both Florida and Oklahoma have abandoned their experiments with periodic, zero-base budgeting reviews, New Hampshire Governor John Lynch and Idaho Governor C. L. “Butch” Otter recently have instituted them for budget analysis and planning.

Zero-base agency reviews are primarily an executive branch responsibility in both states, where they shape the budget recommendations made to the legislatures. The practice does not significantly affect legislative budgeting processes, however, except as agency directors refer to the findings or results of a zero-base analysis in order to submit recommendations to legislators.⁷

Budgeting in New Hampshire is built within the framework of statutory requirements that the executive budget proposal begin with a maintenance-level budget. Governor Lynch instructed all state agencies to build their budget requests for FY 2008 and FY 2009 from the bottom up, using a zero-base budgeting approach. For FY 2012 and FY 2013 he requested a similar approach, but without using the term “zero-base budgeting,” in his directions.

According to the state budget director, John Beardmore, the process includes a full review of agency missions, legal requirements, organizational charts and consideration of alternatives to existing practices. The review asks: What does the agency do? Why does it do it? How is it staffed? What legal requirements must the agency meet?⁸

Beardmore reports that such reviews have helped streamline agency responsibilities. In the recent past, executive orders have reduced New Hampshire agency budgets by 5 percent. For the next biennium, agencies must comply with a legislative directive to present proposals for cutting spending by 10 percent.⁹ Zero-base budgeting can help clarify the central missions and priorities of agencies and eliminate programs that no longer match current priorities.

Idaho’s use of zero-base budgeting is similar to New Hampshire’s, with perhaps more emphasis on clarifying the priorities and strategic plans of state agencies. Governor C. L. “Butch” Otter laid out agency reviews on a six-year schedule,

starting in 2008. The challenge, according to David Hahn of the Idaho Division of Financial Management, was to avoid the excessive paperwork and overemphasis on alternative decision packages and funding levels of the original zero-base budgeting model of the 1970s.

The Idaho Budget Bureau is reviewing 10 to 15 agencies each year, with a goal of identifying gaps between agency activities and statutory requirements. Over time, agencies may have acquired legal responsibilities that are only distantly connected to or even disconnected from their central mission. Agencies are reviewing their activities, identifying those not in line with their mission and recommending whether such activities should be continued, eliminated or moved to another agency. Activities that don't align with central missions are placed at the bottom of the list of priorities.

Idaho has also emphasized keeping zero-base budgeting in the context of strategic planning. Agency strategic plans are essential in prioritizing agency functions. With a strategic plan and functions rank by importance, agencies have been better-situated to make recommendations in line with the required budget reductions of recent years.

Hahn is confident that management techniques exist to extend zero-base budgeting from small agencies to large ones like the Idaho Transportation Department and the Department of Health and Welfare. He cautions that this form of zero-base budgeting will not result in huge cost-savings. It is merely a tool for cost containment, used in Idaho to streamline agencies, focus them on their core missions and implement their strategic plans. It is a management tool as well as a budgetary tool.¹⁰

5. The Appeal Continues

In recent years, 17 states have used zero-base budgeting in some form and several more have made serious efforts to do so. Fifteen state legislatures considered bills calling for some form of zero-base budgeting in 2009, two did so in 2010, and at least nine considered legislation in 2011. They include a mix of small and large states: Iowa, Kansas, Rhode Island and South Carolina among the smaller ones, and California, Georgia, Illinois and Ohio among the larger ones. Despite this widespread interest, none of the enabling legislation has been enacted between 2009 and 2011.

In analyzing proposals for its legislature, the Illinois Legislative Research Unit found no real evidence of actual application of zero-base budgeting in most of the 17 states that report using it.¹¹ Aside from the recent executive orders in Idaho

and New Hampshire, it is unclear that any state uses zero-base budgeting as a primary budgeting technique.

6. Lessons Learned

Disadvantages aside, zero-base budgeting appeals to a serious and widespread desire to look at public budgeting in a fresh new way, free of old assumptions, not letting past experiences control the future. So, what can be learned from the kinds of experiences related here?

- A proposal to adopt zero-base budgeting should be clear on whether it is expected to be an analysis of all government, a tool to respond to a fiscal crisis, or a periodic, revolving review of state agency operations and budgets.
- In any of its forms, zero-base budgeting is likely to be an elaborate and time-consuming process, and can add complexity to the current budget process.
- Continued commitment from leadership and a commitment of time from legislators immediately involved are essential to make it useful to a legislature.

APPENDIX 1: 2011 STATE LEGISLATION PROPOSING ZERO-BASE BUDGETING

Except for SB 33 in Georgia and HB 627 in North Carolina, none of the measures listed proceeded to a floor vote in either chamber.

Georgia SB 2, 33	SB 2 would have established a sunset review process. SB 33 called for phasing in zero-base budgeting and creating a joint budget office for the legislature. SB 33 passed the Senate, was significantly amended in House and was left in conference committee at the end of session.
Illinois HB 33 and SB 212	These bills consisted of only a short title.
Minnesota H File 2 and S File 146	HF 2 would have established principles and requirements for use of zero-base budgeting, and also would have established a sunset review process, principles and practices, and a schedule for state agency sunset reviews. SF 146 would have required priority-based budgets beginning with FY 2014 and included the provisions of HF 2 regarding a sunset process.
North Carolina HB 627	The bill would establish a joint legislative study commission to use a zero-base budgeting review process to identify obsolete programs, cost-reduction opportunities in state government, and instances where funds could be redirected to other purposes. The commission would have served in 2011 and 2012. The House passed the bill, and it will be carried over to the 2012 session of the General Assembly.
Rhode Island HB 5325 and SB 298	These identical bills called for zero-base budgeting to be phased in over five years beginning in FY 2012. They would have established a joint committee to examine the governor's budget proposal to make recommendations for cost savings and alternative agency tactics before the budget goes to the House appropriations committee.
South Carolina HBs 3528 and 3641 and SBs 15 and 68	These companion bills called for the appropriations committees to use a zero-base budgeting process over a four-year cycle beginning in FY 2010. HB 3641 contained more details about practice, and also called for biennial budgeting. SB 68 called for outside auditors to use zero-base budgeting for state agencies in their reviews.
South Dakota HB 1103	This bill called for the joint committee on appropriations to establish a schedule whereby each state agency uses a zero-base budgeting format once every 10 years.
Virginia SJR 355	This resolution recommended that the governor include

	zero-base budgeting as one of the reforms to be considered by the Commission on Government Reform and Restructuring.
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APPENDIX 2: DEFINITIONS OF AND REQUIREMENTS FOR ZERO-BASE BUDGETING

Policymakers' understanding of zero-base budgeting has evolved since it was introduced to the federal government in the 1970s, as recently introduced state legislation indicates. In a number of instances, bill drafters' definitions of or goals for it focus as much on information about agency purposes and operations as they do on a system of allocating resources.

One 2011 bill stands out, both for advancing a legislatively centered zero-base budgeting process and for adhering to the original form of zero-base budgeting. North Carolina House Bill 627 passed the House of Representatives and was carried over to the 2012 session of the General Assembly. It proposes a joint legislative study commission to meet for two years using a zero-base budgeting review process to find obsolete programs and opportunities for savings and redirect existing funding. After deciding what agencies to review, the commission could require them to identify decision packages representing either agency objectives or agency programs. Each decision unit would then be divided into four separate decision packages that would document the effects of minimum, reduced, current or enhanced funding on the services identified in the decision unit. Attention is to be given to the possibility of the private sector replacing agency services, either through simply shedding a service or outsourcing, and to arrangements for current state employees to establish non-governmental organizations to compete for outsourcing opportunities.¹²

Another detailed description of zero-base budgeting in 2011 legislation appeared in Minnesota House File 2, which failed to pass but would have required the governor's budget submission to the legislature to include a variety of activities in addition to classic zero-base budgeting:

- A description of each budget activity for which the agency or entity receives an appropriation in the current biennium or for which the agency or entity requests an appropriation in the next biennium.
- For each budget activity: three alternative funding levels or ways of performing the budget activity, at least one of which is less than the previous biennium's actual expenditures for that budget activity; a summary of the priorities that would be accomplished within each level compared with a zero budget; and the additional increments of value that would be added by the higher funding levels compared with what would be accomplished if there were no funding for the activity.

- For each budget activity: performance data; the predicted effect of the three alternative funding levels on future performance; and one or more measures of cost efficiency and effectiveness of program delivery, which must include comparisons with other states or entities with similar programs.

The bill also would have required the governor to rank budget activities within an agency or program area, and if activities in more than one agency or program were meeting the same goals, the prioritization was to extend across all of them, including agencies or programs not scheduled for zero-base budgeting reviews in that biennium.

The bill proposed amending statutory language setting the format for performance data in budget proposals to require: a description of the goals and objectives of each program and activity within an agency; and that performance measures be objective and outcome-based (as well as indicating outputs, efficiency and other measures as in existing law). It also would have strengthened the requirement for setting targets for future performance.¹³

Georgia's 2011 legislation went further than the Minnesota bills in presenting zero-base budgeting as a variation of performance reporting and budgeting. The bill would have required agencies to prepare a zero-based budget at least once every six years and included these specific requirements:

- A statement of the budget unit's departmental and program purposes; effectiveness, efficiency, and equity measures; and program size indicators; and
- A priority listing encompassing all alternative funding levels for all programs.¹⁴

Although these broad directives can be interpreted to include most of the elements of the original form of zero-base budgeting, they lack its focus on decision packages and their rankings by various levels of administrative staff. This version of zero-base budgeting appears to be a mixture of performance reporting (which does not by itself entail performance budgeting) and alternative or target budgeting (which requires agencies to present various possible budget amounts with their policy and service implications).

Massachusetts' Senate Bill 1619 of 2011 stuck closer to the original definition of zero-base budgeting as defined for the federal government in the 1970s, and stayed away from details: The bill specifies that:

...Zero-based budget shall reflect the amount of funding deemed necessary to achieve the most cost-effective performance of each agency or

department pursuant to an accompanying narrative delineating the tasks to be performed by that agency or department, together with goals and objectives for each agency or department for a period not to exceed four years. Said budget shall have a zero dollar amount as its basis, and shall not reflect any prior appropriation amount, adjusted or otherwise.

Zero-based budgeting shall mean ... a means of developing appropriations based on the cost-effective achievement of the tasks and goals of a particular agency or department without regard to prior appropriations, adjusted for inflation or otherwise. Any appropriation so developed shall to the extent possible, be accompanied by a brief description of said tasks and goals together with the performance measure of the achievement of those tasks and goals.¹⁵

Rhode Island's 2011 proposal was almost as brief, but emphasized descriptions of the functions and operations of agencies.

The budget request shall be accompanied by a statement giving facts and explanations of reasons for each item requested. It shall include a brief explanation of the functions of each of the divisions, boards, commissions, officers, bureaus, institutions or agencies of the state included within the department and comments on its policies and plans, with such descriptive, quantitative, comparative and other data as to work done and other information as is considered necessary or desirable. "Zero based budget" requests so-called, requests for appropriations based upon a justification of a department from a zero base as if the budget for the department was being initiated for the first time shall be required [based upon a multi-year schedule].¹⁶

In contrast to legislation that seems to meld zero-base budgeting with performance reporting, performance-based budgeting and priority budgeting, Idaho's current practice of zero-base budgeting focuses on clarifying agencies' statutory responsibilities and prioritizing tasks by how well they support the agency's mission. The two main goals of zero-base budgeting in Idaho are to:

- Identify an agency's core mission and any gaps that exist between what it is required to do, what it is doing, and what it should be doing as a result of a thorough review of its legal mandates;
- Ensure that every resource is used to its maximum potential to create the most efficient and effective organization possible with the money appropriated to it.

Agencies review their activities and identify those not in line with their central mission. Known as "gap analysis," it includes asking these questions:

- Does the program and its services support and contribute to the mission of the agency?
- Do they meet their constituents' needs?
- Is there any measureable evidence of the value of the service or program under review?
- Are goals and objectives of the program important enough to warrant the expenditures made?
- What would happen if the program and its services were not provided at all?
- Are there other less costly, more efficient ways of achieving these objectives?
- Would benefits be greater if all or part of the funds spent was used for other programs?

When gaps between authority and activities are identified in Idaho, agencies decide whether such activities should be allowed or eliminated (which might require a change in law), or moved to an agency where the activity would be a better fit. This process is part of the agencies' zero-base budgeting responsibility to prioritize their programs and activities. Activities that do not align with their agency's central mission can be placed at the bottom of the list of priorities.¹⁷

Taken together, the bills that defined zero-base budgeting in 2011 suggest legislators' concerns are only partly to begin budgeting anew, as zero-base budgeting originally promised to do. The bills show, in various ways, a greater desire for information on how state agencies operate and how their work can be evaluated, and reflect lawmakers' concerns that their budget enactments be well-informed.

Notes

¹ NCSL, "What is Zero-base Budgeting?" at <http://www.ncsl.org/default.aspx?tabid=12578>; Irene Rubin, *The Politics of Public Budgeting*, 6th edn. (Washington, D.C.: CQ Press: 2010), 82-83.

² This discussion is based on Donald Axelrod, *Budgeting for Modern Government*, 2nd edn. (New York: St Martin's Press, 1995), 305-320.

³ Thomas P. Lauth, "Georgia: Shared Power and Fiscal Conservatism," in Edward J. Clynch and Thomas P. Lauth, *Budgeting in the States: Institutions, Processes, and Politics* (Westport, Conn.: Praeger Publishers, 2006), 47-48.

⁴ George S. Minmier. *An Evaluation of the Zero-base Budgeting Systems in Governmental Institutions* (Atlanta, Ga., School of Business Administration, University of Georgia: 1975), 131, 157, cited in Axelrod, 311.

⁵ NCSL; Rubin.

⁶ Axelrod, 312-313.

⁷ Interview with Cathy Holland-Smith, Division Manager, Budget and Policy Analysis, Idaho Legislative Services Office, September 1, 2011; interview with Jeff Pattison, New Hampshire Legislative Budget Assistant, October 4, 2011.

⁸ Interview with John Beardmore, New Hampshire State Budget Director, October 5, 2011.

⁹ 2011 N.H. Laws, Chap. 229.

¹⁰ Interview with David Hahn, Idaho Division of Financial Management, October 6, 2011. Also see the Idaho Division of Financial Management's resources on zero-based budgeting, at http://dfm.idaho.gov/st_agency_guide/zbb.html

¹¹ Illinois General Assembly, Legislative Research Unit, *Zero-Based Budgeting in Other States* (November 20, 2008). <http://www.ilga.gov/commission/lru/34.ZeroBasedBudgets.pdf>

¹¹ Minnesota House File 2 of 2011 (remained in committee at the end of session). <https://www.revisor.mn.gov/bin/bldbill.php?bill=H0002.2.html&session=ls87>

¹¹ Georgia Senate Bill 33 of 2011 (remained in conference committee at the end of the 2011 session). <http://www.legis.ga.gov/Legislation/en-US/display.aspx?Legislation=32266>

¹¹ Massachusetts Senate Bill 1619 of the 187th General Court. <http://www.malegislature.gov/Bills/187/Senate/S01619>

¹¹ Rhode Island House Bill 5235 of 2011 (held in committee at the end of the regular session). <http://www.rilin.state.ri.us/BillText/BillText11/HouseText11/H5325.pdf>

¹¹ Interview with David Hahn, Budget Bureau, Idaho Division of Financial Management, October 6, 2011, and information on the division's website: http://dfm.idaho.gov/st_agency_guide/zbb/ZBB_QuestionsGapAnalysis.pdf
http://dfm.idaho.gov/st_agency_guide/zbb/ZBB_Presentation.pdf

¹² North Carolina House Bill 627 of 2011 (carried over to the 2012 session). <http://www.ncleg.net/Sessions/2011/Bills/House/PDF/H627v2.pdf>

¹³ Minnesota House File 2 of 2011 (remained in committee at the end of session). <https://www.revisor.mn.gov/bin/bldbill.php?bill=H0002.2.html&session=ls87>

¹⁴ Georgia Senate Bill 33 of 2011 (remained in conference committee at the end of the 2011 session).
<http://www.legis.ga.gov/Legislation/en-US/display.aspx?Legislation=32266>

¹⁵ Massachusetts Senate Bill 1619 of the 187th General Court.
<http://www.malegislature.gov/Bills/187/Senate/S01619>

¹⁶ Rhode Island House Bill 5235 of 2011 (held in committee at the end of the regular session).
<http://www.rilin.state.ri.us/BillText/BillText11/HouseText11/H5325.pdf>

¹⁷ Interview with David Hahn, Budget Bureau, Idaho Division of Financial Management, October 6, 2011, and information on the division's website:
http://dfm.idaho.gov/st_agency_guide/zbb/ZBB_QuestionsGapAnalysis.pdf
http://dfm.idaho.gov/st_agency_guide/zbb/ZBB_Presentation.pdf



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February 1, 2013

William F. Welch
Clerk of the Senate
State House, Room 335
Boston, MA 02133

Steven T. James
Clerk of the House of Representatives
State House, Room 145
Boston, MA 02133

Dear Mr. Welch and Mr. James:

We have the honor of transmitting to the General Court the report of the Zero-Based Budget Commission, established by Section 130 of Chapter 165 of the Acts of 2012.

Thank you for your attention to this.

Sincerely,

Mark Fine, Chair
Executive Office of Administration
and Finance

Martin Benison
Comptroller of the Commonwealth

Dee Richardson, Office of the Treasurer
and Receiver General

Pamela Lomax, Office of the Auditor

Luc Shuster, Massachusetts Budget
and Policy Center

Steve Poflak, Rappaport Institute,
designee of the Pioneer Institute

David Luberoff, designee of the
Massachusetts Taxpayers Foundation



Report of the Zero-Based Budget Commission
Commonwealth of Massachusetts
February 1, 2013

I. Executive summary

The Zero-Based Budget Commission, which was established in accordance with *An Act to Improve the Administration of State Government and Finance* (Chapter 165 of the Acts of 2012), has, as the law required, considered the desirability and feasibility of transitioning the Commonwealth to a zero-based budget for the fiscal year beginning on July 1, 2016.

After reviewing current budget development practices, research from other state's experiences with program, performance-based and zero-based budgeting and the Patrick-Murray Administration's efforts to implement performance management and develop a program budget, the Commission concluded that adopting a comprehensive zero-based approach for budget development was not a desirable, feasible or sustainable course of action for the Commonwealth of Massachusetts. This conclusion is based on the Commission's understanding that, while many other states have tried to adopt zero-based budgeting, it often proved ineffective and generally was unsustainable on a comprehensive basis. The Commission further concluded that many states have found that a program-based approach, combined with the use of realistic and appropriate performance measures, has improved budget decision-making, as well as transparency and public accountability. It also concluded that such an approach could enable the strategic and effective use of in-depth reviews of select programs' performance and finances, and that such reviews would be consistent with the best elements of so-called "zero-based" models adopted in other states.

For all of these reasons, the Commission believes that rather than moving towards zero-based budgeting, the Commonwealth should continue and enhance the budget and performance reforms currently being implemented by the Executive Office of Administration and Finance. The Commission further concluded that implementing these reforms would be greatly aided if the

executive and legislative branches would jointly embrace these approaches as the best means of developing the Commonwealth's budget in the future.

Consistent with these conclusions, the Commission endorsed several recommendations for the executive and legislative branches. Most notably, the Commission believes that:

- The legislature, represented by the Senate and House Ways and Means Committees, and the Executive Office for Administration and Finance on behalf of the executive department, should work together to reform the method by which appropriations are made, through both the General Appropriations Act and supplemental appropriations acts, so as to improve budget development and decision-making associated with allocating the state's financial resources. Specifically, the legislature and executive should work together to:
 - Adopt and agree on a program structure for appropriations in the General Appropriations Act;
 - Make budgetary line-item accounts used for appropriations, as required by Chapter 29 of the Massachusetts General Laws, consistent with an agreed program structure;
 - Identify performance measures for the majority of program-based line-items and use these measures to inform budget development and decision-making;
 - Ensure that performance measures and data identified for program-based line-items are made publicly available as part of the Governor's annual budget recommendation;
 - Ensure that historical and comparative information from the current line-item structure and any new program-based line-item structure that is adopted is made publicly available so that spending trends can be effectively analyzed;
 - Refine the incremental budget development process to allow for the incorporation of select program reviews based on performance information; and
 - Agree a set of criteria and a process by which to determine which programs should be reviewed and ensure that said reviews are conducted to a timeframe that allows the executive to incorporate review findings into the Governor's annual budget.

- The legislature and the executive branches should work together to ensure that both branches have the resources and capacity to effectively measure program performance, incorporate and use performance information in budget development and decision-making, effectively assess the short-and long-term impacts of different appropriations levels on programs and conduct program reviews designed to improve the effectiveness and efficiency of programs.
- The legislature and the executive department should develop an implementation plan to accomplish these recommendations, targeting complete implementation for the Fiscal Year 2016 General Appropriations Act.
- In developing proposals and implementation plans for performance-based program budgeting, the legislature and executive should consult regularly with the Comptroller, Treasurer and Receiver-General and the State Auditor, as well as outside experts, to ensure proposals and plans are consistent with the best accounting, audit, financial and performance management practices.

II. Membership, meeting schedule and staff support

The Zero-Based Budget Commission was established pursuant to Chapter 165, Section 130 of the Acts of 2012 (*An Act to Improve the Administration of State Government and Finance*). The Commission's membership is prescribed in that legislation, as follows:

“The members of the commission shall be the treasurer, or the treasurer’s designee; the secretary for administration and finance, who shall serve as chair, or the secretary’s designee; the comptroller, or the comptroller’s designee; the auditor or the auditor’s designee; and 4 members appointed by the governor with expertise in public finance, 1 of whom shall be chosen from a list of 3 nominees provided by the Massachusetts Budget and Policy Center; 1 of whom shall be chosen from a list of 3 nominees provided by the Massachusetts Taxpayer’s Foundation, 1 of whom shall be chosen from a list of 3

nominees provided by the Pioneer Institute and 1 of whom shall be chosen from a list of 3 nominees provided by the Massachusetts Institute for a New Commonwealth.”

Accordingly, the following members were named to the Commission:

Jay Gonzalez, Secretary of Administration and Finance, Chair*

Mark Fine, Administration and Finance, chair-designate for Secretary Gonzalez

Dee Richardson, Office of the Treasurer and Receiver General, designee

Pamela Lomax, Office of the State Auditor, designee

Martin Benison, Comptroller of the Commonwealth

Luc Schuster, Massachusetts Budget and Policy Center

Steve Poflak, Rappaport Institute for Greater Boston, Harvard University, designee of the Pioneer Institute

David Luberoff, Boston Area Research Initiative, Radcliffe Institute for Advanced Study, Harvard University, designee of the Massachusetts Taxpayers Foundation

**After the Commission's first meeting, Secretary Gonzalez designated Mark Fine, the Director of Strategic Planning and Performance Improvement in the Executive Office of Administration & Finance, as chair-designate for the remaining sessions.*

The Commission met three times – on November 27, 2012, December 18, 2012 and January 15, 2013. The Commission met in the Executive Office of Administration and Finance's (EOAF) conference room in the State House. In addition to Commission members, a number of people also attended and participated in these meetings representing EOAF, the Ways and Means Committees from both the House and Senate and Accenture, which has been supporting EOAF in the development of a program budget.

Staffing for the Commission was provided from EOAF, with support from Bill Kilmartin from Accenture who provided valuable facilitation of Commission deliberations on options for reform. Andy Munemoto, a budget analyst in EOAF, recorded the business of the Commission and drafted minutes. Sean Faherty, the Assistant Budget Director and Helen O'Malley, a program

manager in EOAF presented work on current budget practices and ongoing efforts to develop a program budget.

Meeting agendas and minutes can be accessed online alongside this report at www.mass.gov/eoaf.

III. Definitions

There are a number of key terms used throughout this Report.

Incremental or Maintenance Budget(ing): A budgeting approach that emphasizes appropriations based on what is needed to sustain the current level of services into the following fiscal year.

Performance-Based Budget(ing): A budgeting approach that incorporates performance information into the budget development and decision-making process. Most commonly this occurs by identifying performance outcome measures for accounts or programs.

Program: A set of related activities or tasks that work together to achieve a common goal or objective. Programs are identified with the departments that provide the service and with a specific funding amount for that program.

Program Budget(ing): A budgeting approach which presents spending recommendations and actual expenditures using program as the basis, while maintaining the relationship of the program to the department(s) which provides the activity or service and the line-item and funding source through which the program is funded.

Zero-based Budget(ing): As set out in Section 130 of Chapter 165 of the Acts of 2012, a zero-based budget is defined as a:

- Budget where appropriations are developed based on the cost-effective achievement of the tasks and goals of a particular agency or department without regard to prior appropriations, adjusted for inflation or otherwise;
- Has a \$0 dollar amount as its basis; and
- Reflects the amount of funding deemed necessary to achieve the most cost-effective performance of each agency or department.

IV. The Commission's charge

The Commission's official charge is described in that legislation, as follows:

“There is hereby established a zero-based budget commission to consider and make recommendations concerning the feasibility of transitioning to a zero-based budget for the fiscal year beginning on July 1, 2016. The commission shall:

- Consider and make recommendations regarding any legislative or administrative changes necessary to require, at a frequency of not less than every 4 years, that the budget filed by the governor under sections 6, 6C, 6D and 7H of chapter 29 of the general laws be a zero-based budget.
- Consider section 4A of chapter 6A of the General Laws and make recommendations concerning the presentation of each appropriation or set of appropriations for each agency or department so that a zero-based budget would include the strategic plan for program activities and performance goals of each agency or department for a period not to exceed 4 years, together with the performance measure of the achievement of those tasks and goals.
- Prepare a report of the findings and recommendations together with drafts of legislation necessary to implement those recommendations, and file the report, findings and recommendations with the clerks of the senate and house not later than February 1, 2013.”

V. Goals and principles

While the Commission was charged with considering the feasibility of transitioning to a zero-based budget, Secretary Gonzalez asked that the Commission consider the scope of its work more broadly. As shown above, Section 130 linked consideration of zero-based budgeting to strategic plans, program activities and performance goals and measures for agencies and departments. Therefore, the invitation Secretary Gonzalez sent out to Commission members in advance of its first meeting described the Commission's charge as "improving the way state government allocates state resources and investments by using better data and evidence to inform our budget decision-making."

During its deliberations the Commission concluded the following:

- The Commission should consider reforms that would help the Commonwealth to more effectively allocate resources and present that information to the public;
- Certain areas of spending are less amenable to budget reform because the funding is heavily based on statutory criteria and may not be discretionary for state government. Debt service, state employee benefits spending and federal matching funds are examples;
- Transparency is important and budget reforms must be easily understandable to members of the public;
- The feasibility and cost of reform options must be considered, as other states' previous efforts to move from incremental budgeting to full zero-based budgeting had failed in part due to heavy administrative resource requirements;
- Program, performance-based and zero-based budgeting were not exclusive options and could be implemented in unison, but this would be difficult to do in a short time; and
- A weakness in the current incremental budgeting process is the inability to adequately consider and understand the full impacts of different appropriations levels on programs.

With the above in mind, the Commission agreed on the following goals and principles:

Overarching goal: To establish budget development practices that support policymakers with better information to determine an effective allocation of the state’s financial resources.

Supporting goals: To enable more effective decision-making on the allocation of state resources, reforms should aim to:

- Link performance information to budget decisions;
- Enable greater transparency and public engagement; and
- Ensure service and funding level impacts can be adequately assessed as part of budget decisions.

Guiding principles:

- The reform options under consideration (program budgeting, performance-based budgeting, and zero-based budgeting) are not mutually exclusive;
- Reforms must be implementable and sustainable;
- Reforms may not be applicable to all “spending types” – non-discretionary types of spending such as pensions, debt service, local aid and federal reimbursements may not lend themselves to certain reform options.

Using these goals and principles, the Commission assessed options for reform and developed recommendations (which are described in Sections VIII and IX below)

VI. Current Commonwealth practices and reform efforts

The Commission discussed current budget development practices in the Commonwealth, as well as the efforts of the Patrick-Murray Administration to reform those practices by developing a program budget and implementing performance management.

Current practices and the presentation of the Budget (known as the General Appropriations Act or GAA) reflect statutory requirements within Chapter 29 of state finance law. To develop the annual budget, EOAF and the Legislative Ways and Means Committees utilize an incremental

budgeting approach. This means that budget levels are initially based on what is needed to sustain the current level of services into the following fiscal year. This is called a maintenance budget and does not include proposed expansions or cuts.

Analysis during this process focuses on cost drivers, i.e. what is driving increasing or decreasing costs and where and why are these variances occurring. All state agencies and departments prepare spending requests for the next year that estimate how much it will cost to offer the same level of service. Costs increase year-to-year due to many factors including service demands and caseload changes, contractually required wage increases, rising costs, particularly for health-care, legislative mandates and other factors. EOAF works with agencies to look at these cost-drivers and determine the appropriate estimated amount for next year's funding. Once approved, EOAF releases its maintenance projections back to agencies as the base for building their proposals for the Governor's next fiscal year budget recommendation.

Once maintenance projections have been released back to agencies, they begin work on turning their maintenance submissions into their budget proposals. Reduction targets and expansion requests are then applied to the maintenance base to develop an initial estimate of next year's budget needs. Depending on the revenue situation they may be asked to submit both expansion proposals and cut proposals. Expansion is defined as substantial program growth or the introduction of new programs or services from the prior fiscal year. Reductions are implemented when declining revenues require a decrease in spending – and often reduction targets are given to secretariats based on the size of their expenditures. All proposals must be accompanied by recommendations from secretariats and agencies – where they must also set out the impacts of cuts on current services.

The Commission discussed the strengths and advantages of current practices. Among the strengths considered were stability and ease of operation. This occurs because next year's decisions reflect actual financial information on prior year service levels, caseloads and spending. In this way, incremental budgeting entails limited fluctuations in the distribution of funds from fiscal year to fiscal year. When revenues and costs rise (or fall) by about the same amount, budgets are generally stable and change is gradual. Managers have reliability in funding

and can operate their departments on a more consistent basis. The budgeting process is also considered relatively simple to operate and co-ordination between the operating, capital and federal budgets is seen as easier to achieve.

But the Commission noted several weaknesses in current practice. Incremental budgeting does not encourage new ideas and innovation – it assumes programs and methods of delivery will not change significantly. There is little incentive to reduce costs or increase efficiency – surpluses and savings generally result in lower appropriations the following year. The budget and appropriations within it can become stale as programs continue year-to-year with little review – and the process does not consider program performance. The incremental approach does not account for changing priorities.

The Commission agreed that current practice does look at alternative options through the reductions and expansions process. In that way, it reflects some of the behaviors undertaken as part of zero-based budgeting exercises. The capacity of state agencies to rigorously evaluate impacts of different funding levels was seen as a weakness in current budget development. It made looking critically at various cuts options difficult. The incentive for agencies to present impact analysis in a way that was favorable to their programs was also seen as a challenge in assessing funding options.

The Commission was also interested in the Patrick-Murray Administration's ongoing efforts to reform budget practices by linking performance information and spending and was provided an update on those plans. The Patrick-Murray Administration's efforts were initiated when Governor Patrick signed Executive Order 540 in February 2012. EO 540 established the policy framework for embedding strategic planning and performance management across state government. EO 540 also required that a performance-based program-budgeting approach be adopted by the Administration and that such an approach should be incorporated into the budget beginning with the Governor's Fiscal Year 2014 budget recommendation.

As per EO 540, the Governor's Fiscal Year 2014 budget recommendation was recently published in both the current line-item format and also in a new program format, including a web version

of the program budget that is aimed at making it easier for the public to explore and understand the proposed budget. Alongside the budget, two-year strategic plans were published for each Secretariat laying out their mission, vision, goals, actions and performance measures for the period between 2013 and 2015.

EOAF officials described these products as forming the building blocks for defining programmatic outcomes that measure the results being achieved by programs. Organizing the budget by program is considered a prerequisite for managing and reporting on performance. Once programs are identified, performance measures can be developed and published that permit managers, legislators, advocates and the general public to assess how a program is performing.

During the next year, EOAF plans to work with Secretariats and agencies to identify performance measures at the level of individual programs. This information is to be presented with the Governor's FY15 budget recommendation. The end goal is for performance information to be used to inform budget decision-making.

VII. Research on other state's experiences

To inform the Commission's deliberations, EOAF officials and consultants presented research into the experiences of other states with program, performance-based and zero-based budgeting. This research was based in part on analyses conducted by the Government Finance Officers Association (GFOA), the National Conference of State Legislatures (NCSL), the National Association of State Budget Officers (NASBO) and the National Advisory Council on State and Local Budgeting. EOAF officials and consultants also had direct discussions with officials from Georgia, Virginia, Ohio, Hawaii, Rhode Island, Washington State and New Jersey about their experiences with different approaches to budget development.

A. Zero-based budgeting experiences

NCSL estimated that in recent years 17 states have tried to use some form of zero-based budgeting, although there are questions about whether it has been fully implemented or

attempted in many of these instances. 15 state legislatures considered bills during 2009-2011 that supported some form of zero-based budgeting, but few proposals were adopted.

The genesis of zero-based budgeting in the public sector was in the State of Georgia. Former President Jimmy Carter promoted zero-based budgeting as Governor as a means to control expenditures and then took his approach to the federal level. The approach used in Georgia and at the federal-level in the 1970s was focused on identifying “decision units” within agencies and developing funding option packages that showed the tradeoffs inherent in different funding levels for each unit. But this “original” approach adopted in Georgia was eventually deemed unworkable and discontinued. The focus on different funding packages was not well integrated into the budget process and deemed impractical for allocating resources. This original approach had all but disappeared by the 1980s.¹

Several states have attempted alternative models of zero-based budgeting since that time. According to NCSL, Florida established an eight-year cycle of agency review in 2000 – jointly conducted by executive and legislative officials. These reviews were discontinued after being found expensive and time consuming. Oklahoma adopted periodic reviews in 2003, but the time consuming nature of these reviews meant that they could not be incorporated into budget decisions. Oklahoma has since moved to performance budgeting. New Hampshire Governor John Lynch asked for “zero-based” reviews in 2008-9 and again in 2012-13. Reviews focused on agency functions, staffing and statutory requirements. Governor Lynch specifically asked for options for cutting spending by 5% indicating that the exercise was aimed at determining budget reductions as opposed to using zero as a starting point for development. The Idaho Budget Bureau conducts 10-15 reviews of agencies each year, with the objective of clarifying agency priorities and strategic plans. This is done over a six-year cycle.

Zero-based budgeting has also returned to Georgia. In 2012 Governor Nathan Deal signed a zero-based budgeting law that requires state departments, agencies, boards and authorities to

¹ Zero-Based Budgeting in the States: The National Conference of State Legislatures, 2010

<http://www.ncsl.org/documents/fiscal/ZBB2012.pdf>

submit a ZBB for programs identified by the Governor's Office of Planning and Budget (OPB), in consultation with the House and Senate. Georgia's ZBB reviews look at program activities against statutory responsibilities, program purpose, desired performance outcomes and costs of providing services. The result of these reviews informs the Governor during budget development.²

To learn more about how zero-based budgeting is working currently in other states, EOAF officials held a discussion with two Deputy Directors in the Georgia OPB. EOAF also received an annual zero-based budget report from Georgia which is published and available online (see bibliography).

Key findings from the interaction with Georgia officials demonstrated the importance of linking performance information to budget decision-making. Georgia already had created a program budget and identified performance measures, which their officials saw as prerequisites to zero-based reviews. A critical part of their reviews was analysis of performance goals and measures. In fact, that was the starting point for engagement with agencies in conducting the reviews. They wanted to identify which performance measures were the right measures to assess programs with and then ensure they were tracking and using the right data. This often meant redoing outdated or poor performance measures. Georgia has a performance management program that requires agencies and programs to have performance measures. The program was first established in 1993, according to Georgia officials, when they enacted a Budget Accountability Act. By 1998, performance measures and data were being reported as part of the Governor's Budget Report. Georgia has therefore had an established performance management program for more than a decade.

Georgia ran a zero-based budget exercise on 10 percent of all budgetary programs in 2013, the first year it was statutorily required. This constituted a fairly small proportion of their overall budget – only 2.84% of the state budget for the fiscal year 2013. There were no identified

² George S. Minnier, *An Evaluation of Zero-base Budgeting Systems in Governmental Institutions*, Atlanta, GA, School of Business Administration, University of Georgia: 1975, as cited in *National Council of State Legislatures Fiscal Brief: Zero-Based Budgeting in the States*

criteria for determining which programs were reviewed but there was close collaboration between the legislature and executive in making the selections. Georgia OPB agreed with the House and Senate Budget Offices which programs to select for review that year. House and Senate Budget Office staff also played a role in identifying and determining performance measures. The collaborative process between the executive and legislature in conducting these reviews was noteworthy.

Georgia OPB started their process in February and conducted their reviews to provide the Governor with recommendations by October. The Georgia Governor files his Budget in January each year, similar to Massachusetts.

Georgia officials were specifically asked about whether they started budget consideration at “zero” in conducting financial analysis. They did not start from “zero” as the basis for budget development. They provided agencies with scenarios calling for cuts of both 3% and 10% and asked agencies to provide them information on how such targets could be met and what the impacts of reductions would be. The Commission concluded that while Georgia’s process is called a zero-based budgeting, in practice it appeared to be similar to the Massachusetts’ reductions and expansions process described above. EOAF officials found that the zero-based reviews were more reflective of program and financial evaluations than they were of zero-based budgeting as purely defined.

The Commission also noted that Georgia OPB has 22 budget analysts, five budget division chiefs and three dedicated strategic planning staff that can support zero-based reviews alongside their other responsibilities. In contrast, Massachusetts has a much smaller budget staff in EOAF, with only 12 fiscal analysts and two staff dedicated to strategic planning and performance management. EOAF officials were unable to learn what resource the Georgia State Legislature dedicated to the reviews.

B. Program and performance-based budgeting experiences

In developing its program budget filing with the Governor's FY14 budget recommendation, EOAF officials and its consultants have conducted a number of conversations with states engaged in similar activities. Some common themes have emerged from those discussions, including: the need to create a robust program structure (i.e. a taxonomy with a reporting hierarchy) that is easily understood by the public and is consistent with the structure of government; the need to build stakeholder support for the process, particularly with legislators; and the need to carefully transition so that agencies and stakeholders have time to become comfortable with the new approaches to budgeting.

Through this research, EOAF found that many states are working to enhance their budgeting processes to accomplish attributes consistent with program and performance-based budgeting. This is becoming best practice, more often than zero-based budgeting. Even in states adopting a so-called zero-based approach, the use of program and performance-based tools were more common than a purely zero-based approach to budget development.

The research also showed that states have adopted program-and performance-based initiatives as part of wider efforts to improve state government transparency and civic engagement. Implementation differed between states in adopting these practices. Some states budget by program and also report by program, but many states still retained the traditional line-item structure and did separate reporting by program relating to performance. Similar to zero-based budgeting, the record suggested that attempts to superimpose performance reporting and/or program reporting on top of or in addition to the traditional budget process did not hold up over time.

VIII. Options for reform

The Commission looked at three different approaches to reforming the budget development process: program budgeting; performance-based budgeting; and zero-based budgeting. The Commission agreed that each of these options is asking a different question and addressing a different budget development challenge: program budgeting addressed organizational or structural issues; performance-based budgeting addressed effectiveness and efficiency issues; and zero-based budgeting addressed the starting point for appropriations and the impacts of

different funding levels. Each approach has its own strengths and weaknesses. The following sub-section describes highlights from the Commission's discussion of these options.

A. Options consideration

Program budgeting

Appropriating by program not only can help policymakers better assess the overall distribution of resources but also help them reduce duplicative spending and improve coordination among different agencies and programs. Options for structuring appropriations included by accounting item, agency or by program (as defined in the definitions section above). Current practice in the Commonwealth is to make appropriations by accounting items that correspond to or sit wholly within agencies and departments. In contrast, the benefits of a program budget approach were seen as making appropriations at the level at which actual programs or functions were being delivered. Program budgets could also allow programs to be defined across agencies or departments. While the Commission discussed how cross-agency programs could be problematic because they were not "owned" by a single agency or management chain, such a program structure could enable policymakers and the general public to better understand and evaluate overall spending on a common activity.

While the Commission recognized that this approach was likely to raise questions about whether agencies should be re-organized to reflect a program structure, it concluded that questions about re-organization were outside the scope of its work. Nevertheless, the Commission believes that program budgeting can be a valuable tool that policymakers can use in deciding how the Commonwealth can deliver high-quality public services in more efficient and effective ways.

Performance-based budgeting

Performance-based budgeting was found to be the most practical method of linking performance information to budget decision-making. It does so by identifying performance measures for appropriations/programs and then collecting data for those measures to determine whether

program or agency goals were being met. The Commission believes that performance measures would be beneficial to budget decision-making because they would allow policymakers to consider program performance when determining budget allocations. Doing so requires that policymakers, program managers, and others develop appropriate, feasible, and actionable measures. The Commission further noted that data for performance measurement often only flags where a program may be underperforming, but does not answer why a program may be underperforming. Gaining that understanding generally requires a deeper level of review or program evaluation – assessments that not only look at funding levels but also at how services are delivered.

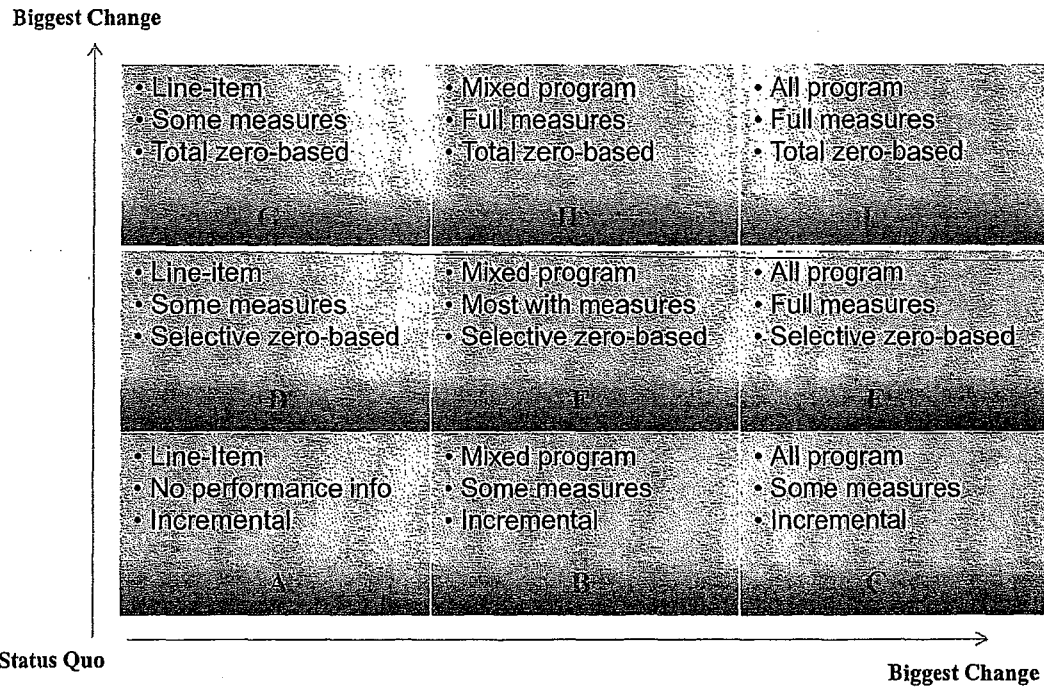
Zero-based budgeting

In principle, zero-based budgeting can help policymakers better assess whether services are being delivered effectively and gauge the impacts of various funding levels on agencies, departments or programs. A pure zero-based approach technically starts by looking at an appropriation assuming a “zero” spending level. In practice however, most zero-based approaches in state government look at the differential impact of a set of budget packages or spending levels on an agency or program. As mentioned above, current budget practice in the Commonwealth is based on an incremental budget approach that does not regularly assess the impact of different funding levels for agencies, departments or programs. A selective and modified -zero-based approach might remedy this weakness in the incremental budgeting approach.

A. Options prioritization

The Commission reviewed a matrix of options (as illustrated below) to prioritize its preferences and shape its recommendations.

Figure 1 – Options Matrix



As shown, the matrix presented options on a continuum moving from the current status quo, as represented by Option A, to the most significant cumulative reform, as represented by Option I.

Based on its shared concerns that a total zero-based approach was not feasible for state government to adopt, the Commission unanimously approved the removal of options G, H and I, which all included a total zero-based approach, from further consideration. The Commission then moved to unanimously remove Options A and D as they were not seen as consistent with the goals of the Commission because the status quo was seen as failing to provide policymakers with the best information by which to determine state appropriations.

Having narrowed down the options, Commission members created two new options for further consideration, Options K and L shown below. The Commission unanimously approved the inclusion of these new options.

Figure 2 – Included Options K and L

<ul style="list-style-type: none"> • All program • Full performance measures • No zero-based 	K	<ul style="list-style-type: none"> • Mixed program • Most performance measures • No zero-based 	L
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The Commission used a “straw poll” to rate the remaining options on a one-to-five scale against the two following questions:

- 1) Would the option deliver a significant degree of change toward our goals; and
- 2) Would it be feasible and sustainable over time?

Below are the results of the poll, demonstrating the consensus of the Commission against the options it sought to consider.

Figure 3 – Straw poll results

Options/Note	B	C	E	F	K	L
Best Meets Goals	17	20	22	24	38	30
Feasibility	29	17	23	11	19	29
Total	46	37	45	35	57	59

IX. Recommendations

Based on its deliberations and findings from other states, the Commission believes that adopting a comprehensive zero-based approach for budget development would not be effective, feasible or sustainable for the Commonwealth. Many other states that have used a zero-based model have not been able to maintain it. Even in states where they are asserting the use of zero-based budgeting, such as Georgia, the approach being taken focuses as much or more on program

performance and evaluation than it does on comparing different levels of funding. Where these forms of “zero-based” budgeting are being used, the implementation of performance management practices, such as strategic planning and the identification of performance measures, together with the adoption of a program structure as the basis for organizing budget appropriations, have proven essential precursors to more in-depth program and financial reviews.

Therefore, the Commission believes that the Patrick-Murray Administration’s current efforts to develop a program-based budget and embed performance management throughout state government are a good start towards reforming budget practices in the Commonwealth. These reforms should be continued and enhanced by linking program budgets and performance measures and then through select reviews of programs based on performance.

Going forward, making such changes and ensuring that they endure will require a partnership between the executive branch and the legislature. Such a partnership has been important in states, such as Georgia, that have incorporated performance and program evaluation into their budget process.

Consistent with these findings, the Commission submits the following set of recommendations to the legislature.

- 1) The legislature, represented by the Senate and House Ways and Means Committees, and the executive department, represented by the Executive Office for Administration and Finance, should work together to reform the method by which appropriations are made, through both the General Appropriations Act and supplemental appropriations acts, so as to improve budget development and decision-making associated with allocating the state’s financial resources. Specifically, the legislature and executive should work to:
 - a. Adopt and agree on a program structure for appropriations in the General Appropriations Act and supplemental appropriations acts. The Patrick-Murray Administration presented such a structure as part of its FY14 budget recommendation and this structure can be the basis leading to an agreed upon program structure;

- b. Make budgetary line-item accounts used for appropriations, as required by Chapter 29 of the Massachusetts General Laws, consistent with an agreed program structure;
- c. Identify performance measures for the majority of program-based line-items and use these measures to inform budget development and decision-making. Some programs may be found to be inappropriate for performance measurement due to the mandatory nature of spending for such programs, such as debt service or employee benefits. The legislature and executive should determine which programs might not be suitable for effective performance measurement and work collectively to scrutinize the quality of performance measures and associated data. The quality of measures and data is important if they are to be used effectively in informing budget decisions;
- d. Ensure that performance measures and data identified for program based line-items are made publicly available as part of the Governor's annual budget recommendation. Performance measures identified for programs should be aligned with the Secretariat strategic plans developed pursuant to the Governor's Executive Order 540 and Chapter 165 of the Acts of 2012, which made Secretariat strategic plans mandatory in statute;
- e. Ensure that historical and comparative information from the current line-item structure and any new program-based line-item structure that is adopted is made publicly available so that spending trends can be effectively analyzed. This information should allow legislators, advocates and the public to identify how the old line-item structure and appropriations have been cross-walked and incorporated into the new program-based line-items for a period of time after the transition to the new structure;
- f. Refine the incremental budget development process to allow for the incorporation of select program reviews based on performance information. These reviews should examine program mission, goals and key activities, performance measures to gauge

effectiveness, financial information to determine efficiency and make recommendations for both program improvement and appropriations based on this information. In addition, said reviews should assess the impacts of different funding levels on service delivery and quality as part of program reviews, including in some cases, whether certain programs should continue to be funded or re-organized in light of their performance; and

- g. Agree a set of criteria and a process by which to determine which programs should be reviewed and ensure that reviews are conducted to a timeframe that allows the executive branch to incorporate the reviews' findings into the Governor's annual budget recommendations.
- 2) Appropriate resources and capabilities should be identified and provided, in both the legislature and executive, to effectively measure program performance, incorporate and use performance information in budget development and decision-making, effectively assess the short-and long-term impacts of different appropriations levels on programs and conduct program reviews to improve the effectiveness and efficiency of programs. As part of their work to reform the method by which appropriations are made and improve budget development and decision-making, the legislature and executive should identify where and how resources and capabilities should be enhanced and make further recommendations for addressing those needs.
- 3) The legislature and the executive department should develop an implementation plan to accomplish Recommendation #1 of this Report, targeting complete implementation for the Fiscal Year 2016 General Appropriations Act. The Governor's Fiscal Year 2016 budget that will be filed in January/February 2015 should be set forth under this new process. The implementation plan should include:
 - a. Any legislation needed to ensure the permanent adoption of a performance-based program budget as the means for making, setting, presenting and enacting appropriations;

- b. Recommendations on which programs or program types should and should not be subject to performance measurement;
- c. Recommendations on resources and capabilities that need to be provided to enable effective implementation and maintenance of a performance-based program budget; and
- d. A process and criteria that the legislature and executive can jointly use to determine which programs should be subject to in-depth review, how such reviews would be conducted and staffed, and how review findings could be incorporated into budget development and appropriations decisions.

Representatives of the legislative and executive branches should determine a timetable for completing an implementation plan and to whom it should be submitted. Preferably, this would occur no later than October 1, 2013 so that a performance-based program budget can be developed for the Fiscal Year 2016.

- 4) In developing proposals and implementation plans for performance-based program budgeting, representatives from the legislature and executive should consult regularly with the Comptroller, Treasurer and Receiver-General and the State Auditor, as well as outside experts, to ensure proposals and plans are consistent with the best accounting, audit, financial and performance management practices. Said constitutional and independent officeholders should consider whether their roles, responsibilities and resources need to be updated or adapted to support performance-based program budgeting and based on this consideration make recommendations to legislative and executive representatives regarding any necessary changes.

The Commission recognizes that these recommendations represent substantial and significant changes in the long-standing procedures and structures used to develop and implement the Commonwealth's budget. Therefore, it does not make these recommendations lightly.

Rather, the Commission makes them in the belief that these alternative approaches will greatly improve the budgeting process and management of state programs and, in doing so, will help ensure that the Commonwealth spends taxpayers' dollars effectively and efficiently in the years to come.

Appendix A: Bibliography

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SUBJECT: MISCELLANEOUS, Adopt zero-based budgeting for state financial plan

BILL NUMBER: SB 2276

INTRODUCED BY: Kim

BRIEF SUMMARY: Amends various sections of HRS chapter 37 to require the state budget and financial plan to be prepared using the zero-based budgeting principles. Every state agency assigned the task of developing programs and preparing program and financial plans, budgetary requests, and program performance reports shall develop such programs and prepare plans, requests, and reports to: (1) assume that the agency has no authorized funds; (2) enumerate the goals and objectives of the agency; and (3) enumerate each specific activity required to accomplish the goals and objectives of the agency, including a justification of each activity, the cost of each activity, and the number of personnel required to conduct each activity.

This measure shall be applicable to state financial plans and budgets for the fiscal 2015-2017 biennium and thereafter.

EFFECTIVE DATE: July 1, 2014

STAFF COMMENTS: This measure would incorporate zero-based budgeting principles when the state budget and financial plan is prepared beginning with the fiscal 2015-2017 fiscal biennium. Under a zero-based budget methodology, each state agency would be required to evaluate their operations based in the initial premise that zero funds have been authorized for any programs. Zero-based budgeting requires that the existence of a government program or programs be justified in each fiscal year, as opposed to simply basing budgeting decisions on a previous year's funding level. While the measure would take effect for the next fiscal 2015-2017 biennium, it is questionable whether there is sufficient time for its successful implementation.

In testimony presented by the Mackinac Center for Public Policy on the subject of zero-based budgeting, "there are both benefits and costs to be taken into account when considering zero-based budgeting. Case studies about businesses and governments that have adopted zero-based budgeting, or some hybrid of it, generally report some improvement quantitatively or qualitatively. That is, the process has either saved money, improved services, or both."

The testimony further states that "in addition to saving money and improving services, zero-based budgeting may: (1) increase restraint in developing budgets; (2) reduce the entitlement mentality with respect to cost increases; and (3) make budget discussions more meaningful during review sessions. On the cost side of the equation, zero-based budgeting: (1) may increase the time and expense of preparing a budget; (2) may be too radical a solution for the task at hand somewhat like using a sledgehammer to pound in a nail; and (3) can make matters worse if not done in the right way. A substantial commitment

must be made by all involved to ensure that disaster doesn't happen. Zero-based budgeting can be useful for shaking up a process that may have grown stale and counterproductive over time."

It further provided three warnings: "First, the success of such a change like this hinges strongly on leadership that is dedicated to the task. If those appointed to conduct budget reviews are unwilling to truly assess every item in their budget, word will get out quickly that this new budgeting technique is more symbolism than substance. Indeed, it is incumbent upon proponents of zero-based budgeting to ensure that those reviewing the budget do not have a pecuniary interest in maintaining the status quo. Allowing people who will be most affected by the elimination of programs to conduct their own reviews may be counterproductive, since most people are quick to defend their own interests. Second, don't attempt to do zero-based budgeting for every department, every year. Such a move may prove impossible to manage. Instead, choose several departments and/or agencies, and rotate through every facet of state government over time. In Oklahoma, which has recently adopted zero-based budgeting, officials are applying the method to two departments and several agencies each year. Once those reviews are complete, the same departments and agencies will not see another zero-based review for eight years. Third, ensure that each review is conducted by referencing all aspects of a department, agency or program to what its goals are. This makes the very purpose of the entity being reviewed transparent, and can increase the opportunities available for making objective measurements of a department, agency or program's success rate."

As with most programs or reforms of programs, it must be done right or it should not be done at all. For example, department, agency or program directors who feel endangered by this kind of scrutiny will be delighted to be placed in charge, so that they can do it wrong, waste everyone's time, and give a cutting-edge management tool like zero-based budgeting a bad name, all at the same time.

Digested 1/27/14