Best Practices in Local Budgeting

Professor Linda J. Bilmes
Harvard Kennedy School, Harvard University
Agenda

1. Local public finance is complex
2. Cities just recovering from deep financial crisis
3. Cities can benefit from
   - Frequent analysis of variances
   - Activity-based budgeting
   - Balanced Scorecard or similar performance metrics
Stages of the Budget Cycle

Budget formulation
Budget Audit
Budget Justification
Budget Execution

Example: Today’s Globe
Local Revenues

- Legally cannot go into deficit
  - so expenditures cannot exceed revenues

- Funding sources:
  - “Own-source” (complex set of taxes, fees)
    - Property tax assessments seldom coincide with market value
    - Volatile revenue stream from user fees and charges
    - Linked to national, regional economy – may be difficult to forecast

  - “Intergovernmental transfers”
    - These constitute 60-75% of revenues in some jurisdictions
    - Significant source of revenue for cities and states (e.g. Medicaid),
    - Simultaneously these are “revenues” to local governments and 
      expenditures to higher level governments
Agenda

1. Local public finance is complex
2. Cities just recovering from deep financial crisis
3. Cities can benefit from
   – Frequent analysis of variances
   – Activity-based budgeting
   – Balanced Scorecard or similar performance metrics
The “Great Recession” in 2008

Figure 2-1.
Real Gross Domestic Product
(Percentage change, fourth quarter to fourth quarter)

Sources: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis.
Notes: Real gross domestic product is the output of the economy adjusted to remove the effects of inflation.
Data are annual through 2011. The value for 2012 is the annualized growth rate for the first half of the year.
Impact on Housing Lags; Impact in 2009, 2011

Figure 2-3.

Housing Market Indicators

(Percentage change from same quarter of previous year)

Sources: Congressional Budget Office; CoreLogic; Department of Commerce, Bureau of Economic Analysis.

Notes: Real residential investment consists of spending on residential construction, improvements to existing housing, mobile homes, and real estate brokers' commissions, adjusted to remove the effects of inflation.

House prices are measured by the CoreLogic National House Price Index.

Data are quarterly and are plotted through the second quarter of 2012.
Figure 2.5.

Long-Term Unemployment

(Percent)

Sources: Congressional Budget Office; Department of Labor, Bureau of Labor Statistics.

Notes: Data show the percentage of unemployed U.S. workers who have been unemployed for longer than 26 consecutive weeks.

Data are annual through 2011. The value for 2012 is the average percentage for the first half of the year.
Impact of Recession on State Governments still felt now

Figure 2
Largest State Budget Shortfalls on Record

Total state budget shortfall in each fiscal year, in billions of dollars

<table>
<thead>
<tr>
<th>Year</th>
<th>Shortfall (in billions of dollars)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>-$40</td>
</tr>
<tr>
<td>2003</td>
<td>-$75</td>
</tr>
<tr>
<td>2004</td>
<td>-$80</td>
</tr>
<tr>
<td>2005</td>
<td>-$45</td>
</tr>
<tr>
<td>2006</td>
<td>-$110</td>
</tr>
<tr>
<td>2007</td>
<td>-$130</td>
</tr>
<tr>
<td>2008</td>
<td>-$107</td>
</tr>
<tr>
<td>2009</td>
<td>-$55*</td>
</tr>
</tbody>
</table>

*Reported to date

Source: CBPP survey, revised June 2012.
General Local Aid is Down 36 Percent from Pre-Recession Levels

Inflation adjusted, 2012 dollars

- 2001: $1,600,000,000
- 2002: $1,400,000,000
- 2003: $1,200,000,000
- 2004: $1,000,000,000
- 2005: $800,000,000
- 2006: $600,000,000
- 2007: $400,000,000
- 2008: $200,000,000
- 2009: $1,000,000,000
- 2010: $1,200,000,000
- 2011: $1,400,000,000
- 2012: $1,600,000,000

-36 percent

Colors and labels:
- Additional Assistance
- Lottery Aid
- Unrestricted General Government Aid (UGGA)
## Local aid cuts (inflation adjusted)

<table>
<thead>
<tr>
<th>CITY/TOWN</th>
<th>FY 2008 (m)</th>
<th>FY 2012(m)</th>
<th>% cut</th>
<th>$ per capita</th>
</tr>
</thead>
<tbody>
<tr>
<td>Boston</td>
<td>$ 251.8</td>
<td>$160.2</td>
<td>36%</td>
<td>$142</td>
</tr>
<tr>
<td>Somerville</td>
<td>$ 32.2</td>
<td>$ 21.2</td>
<td>34%</td>
<td>$142</td>
</tr>
<tr>
<td>Newton</td>
<td>$ 7.8</td>
<td>$ 5.0</td>
<td>36%</td>
<td>$ 34</td>
</tr>
<tr>
<td>Watertown</td>
<td>$ 8.5</td>
<td>$ 5.6</td>
<td>34%</td>
<td>$ 86</td>
</tr>
</tbody>
</table>
Agenda

1. Local public finance is complex
2. Cities just recovering from deep financial crisis
3. Cities can benefit from
   – Frequent analysis of variances
   – Activity-based budgeting
   – Balanced Scorecard or similar performance metrics
Variance Analysis

Key Budget Variances

Price Variance
The difference between the actual price and the expected price

Quantity Variance
The difference between the actual quantity and the expected quantity
Most Cities use line-item budgets

• Focus on “inputs” (e.g., labor, equipment)
• Collected by administrative unit (e.g., departments, units)
• List expenditure by good or service purchased – linked to accounting
Traditional vs. ABC Budget

Traditional Accounting
Salaries $371,917
Benefits $118,069
Supplies $76,745
Equipment $23,614

TOTAL $590,345

ABC Accounting
Pothole Repair $130,600
Resurfacing $240,789
Sidewalk Repair $175,203
Sealing cracks $43,753

TOTAL $590,345
An Overview of City Management from an Activity-Based Costing Perspective

(Note: Information is not comprehensive and is presented for illustrative purposes only)

Organization

Departments

Public Works Department

The City Government

Programs

Electric

Water

Buildings and Grounds

Activities

Multiple City Departments make up the top-level organization

Multiple programs make up a City Department

Multiple activities make up a program

Programs

Electric

Water

Buildings and Grounds

Activities

- Maintain Electrical Systems
- Identify Emergency Utility Markouts
- Provide an Emergency Generator System
- Maintain Systems Radios
- Maintain Fire Alarm Systems

- Maintain Water Quality and Pressure
- Maintain Gate Valves
- Maintain and Read Meters
- Track and Issue Water Permits
- Maintain Hydrants

- Issue Park Permits
- Empty Public Trash Barrels
- Maintain Open Spaces and Lighting
- Move Furniture
- Complete Emergency Repairs

OUUTCOMES

OUTPUTS
Example: Activity Based Costing in the City of Somerville
City of Somerville
Department of Public Works Programs

1. Administration
2. Buildings & Grounds
3. Highway
4. Sanitation
5. Fleet Maintenance
6. Lights and Electric
7. Sewer Operations
8. Engineering
9. Water
10. Weights & Measures
Each Program Defines Activities

1. What services are performed?
2. What is the city actually doing?
3. What does the customer receive as an end output?
4. Define the service as an activity
City of Somerville

Department of Public Works Activity menu

- Snow plowing
- Christmas trees
- Pothole repairs
- Dead animal pick up
- Sidewalk repairs
- Yard waste pick up
- Street light maintenance
- Manhole repairs
- Playgrounds
- Graffiti removal
- Memorials and cemeteries

10 programs (water, sewer, highways, etc)
100 activities (based on what customer receives)
Activity-based costing helps cities better understand costs to:

1. Decide whether a service should be done in-house or contracted out
2. Set user fees in relation to cost
3. Recover costs of running programs mandated by state/federal government
4. Estimate the cost of increasing or decreasing the level of service
5. Set priorities and performance targets
6. Monitor implementation of the budget
The Balanced Scorecard

Financial
“To succeed financially, how should we appear to our shareholders?”

Customer
“To achieve our vision, how should we appear to our customers?”

Vision and Strategy

Internal Business Processes
“To satisfy our shareholders and customers, what business processes must we excel at?”

Learning and Growth
“To achieve our vision, how will we sustain our ability to change and improve?”
Charlotte's Balanced Scorecard: Aligning Vision with Government Performance

Example of a Balanced Scorecard Strategy Map for Jacksonville

Financial Perspective
- Increase Revenue by 5-10% by 2015
- Revenue Growth Strategy
- Increase tax revenues / per acre
- Stimulate private investment & long term economic growth
- Increase commercial occupancy
- Increase residential occupancy
- Increase visitors to downtown

Citizen Perspective
- Improve carbon footprint
- Stimulate a healthy city
- Improve citizen satisfaction
- Connect with the citizen

Internal Perspective
- Encourage Innovation
- Improve and leverage quality
- Increase transparency
- Promote communication and dialog

Learning & Growth Perspective
- Develop a climate for action
- Enhance ability to recruit and retain city talent
- Increase employee satisfaction
- Enhance employee competence

© 2012 IBM Corporation