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## ZERO-BASE BUDGETING

### GENERAL INFORMATION

Zero-base budgeting was first introduced as a budgeting tool by the United States Department of Agriculture in 1964. It was used only for a short time, without much success, by the agency in order to justify its program needs and expenditure requests. In 1969, zero-base budgeting was used successfully by Texas Instruments, Inc., as a method of controlling its overhead costs. During the 1970s, many private businesses and state and federal agencies used zero-base budgeting as their primary budgeting tool. While certain concepts of zero-base budgeting continue to be used today, only a small percentage of organizations use it as their primary budgeting tool.

The purpose of zero-base budgeting is to reevaluate and reexamine all programs and expenditures for each budgeting cycle by analyzing workload and efficiency measures to determine priorities or alternative levels of funding for each program or expenditure. Through this system, each program is justified in its entirety each time a new budget is developed.

Zero-base budgeting involves four basic steps in the development of an organization's budget:

1. Identifying decision units.
2. Analyzing decision units and decision packages.
3. Ranking decision packages in priority order.
4. Preparing the total budget request with the approved decision packages.

#### Identifying Decision Units

Identifying decision units is a determination of an organization's meaningful elements. Generally, decision units are based on an agency's organizational structure and are comprised of a program or cost center of an agency.

#### Decision Packages

Decision packages are the main component of the zero-base budgeting process. A decision package is an actual budget document that identifies a decision unit and describes its specific activities. The purpose of developing a decision package is to evaluate the activity described in the package against other activities competing for funding and to decide if the activity should be

approved or disapproved. Decision packages identify:

1. The purpose of activity or service provided.
2. Measure of the activity or service performance.
3. Cost of the activity or service.
4. Benefits of the activity or service.
5. Consequences of not performing the activity.
6. Alternative actions.

One key to zero-base budgeting is to identify and evaluate alternatives for each activity. Zero-base budgeting stresses that each agency, as it prepares its budget, consider alternative methods of performing the activity or providing a service and alternative levels of effort for performing the activity or service. When the agency determines the best way of performing an activity, it considers various levels of efforts. At this point, decision packages for the various levels of effort are developed based on the recommended method of performing an activity. A decision package is prepared for each level. Levels of effort generally include:

1. Minimal level of effort which is below the current operating level.
2. Level of effort if the funding remains near the present level.
3. Level of effort if funding continues at current levels.
4. Additional levels of effort to fund new programs or activities.

#### Ranking Decision Packages

Once the decision packages for the various levels in an organization are prepared, the decision packages are ranked in priority order.

#### Preparation of Total Budget Requests

When decision packages have been prepared and ranked for all levels within the organization, approved decision packages will constitute the budget request for the agency. During the ranking process, management may disapprove some of the packages ranked at the lower levels. This may happen since the total of all the decision packages may exceed a set amount that the agency may want to request. Once the agency's budget is submitted, the executive budget office and the Legislative Assembly, in making their

adjustments to the budget request, base their decisions on additions or reductions in decision packages considered by the agency in developing its budget request.

### **ZERO-BASE BUDGETING IN NORTH DAKOTA**

During the 1977-78 interim, the Budget Section reviewed zero-base budgeting. As a result of committee action, the State Industrial School, Attorney General's office, Income Tax Division of the State Tax Department, the Hydrology Division of the State Water Commission, and Travel and License Divisions of the State Highway Department were chosen as pilot project agencies to prepare their 1979-81 budget request using zero-base budgeting.

Although North Dakota did not adopt zero-base budgeting as its primary budgeting tool, a number of its components were incorporated into budget request forms used by agencies in preparation of their budget requests submitted to the Office of Management and Budget and Legislative Assembly.

These components include:

1. Preparing decision packages that identify agency services that would be provided at a funding level less than 100 percent of the agency's current funding level, usually 80 or 90 percent of the agency's current funding level.
2. Requiring agencies to submit a 95 or 97 percent budget request compared to current funding levels.
3. Ranking agency activities in priority order above a certain level.
4. Identifying program goals and objectives.
5. Explaining the effect of not funding an activity within an agency.

### **OTHER STATES' USE OF ZERO-BASE BUDGETING**

The states that report utilizing zero-base budgeting to some extent in their budget preparation process are Colorado, Iowa, Nebraska, and Oregon. Listed below is a brief description of each state's use of zero-base budgeting.

#### **Colorado**

Colorado is utilizing zero-base budgeting for the preparation of approximately six agency budgets. It intends to increase the number of agencies using zero-base budgeting for their budget preparation by one or two each year. Agencies involved in preparing zero-base budgets begin at zero and develop decision packages for all activities which

are ranked in priority order in an agency's budget request.

#### **Iowa**

Iowa considers its budgeting method a modified zero-base budget system. An agency may request 75 percent of its current year's funding level as a base. The agency is not required to provide specific justification for this 75 percent base. Generally, an agency's first three decision packages above the 75 percent level are prioritized and return the agency to the current funding level. Decision packages that will increase the agency's request above the current funding level are also prioritized.

#### **Nebraska**

Nebraska considers its budgeting method a modified zero-base budget system. Agencies prepare two separate budget documents--a needs-based budget and a modified zero-base budget. The modified zero-base budget is comprised of decision packages for the funds requested in the needs-based budget request that exceed 90 percent of an agency's current funding level. The decision packages are listed in priority order.

#### **Oregon**

Oregon primarily uses incremental budgeting; however, agencies are asked to prepare 10 to 20 percent reduction decision packages from the current funding level which are considered by the Oregon Legislative Assembly as it develops the approved budget for the agency.

### **ADVANTAGES AND DISADVANTAGES**

Proponents of zero-base budgeting suggest that it is successful because it:

1. Changes budgeting to focus on analysis and decisionmaking rather than on the size of incremental funding increases.
2. Eliminates or reduces low priority programs.
3. Forces managers to examine the cost-effectiveness of each program.
4. Ensures that agencies are using existing resources effectively.

Opponents of zero-base budgeting suggest that it does not work because:

1. Most spending growth results from entitlement programs such as Medicaid and AFDC which cannot be reduced easily.
2. Paperwork and other required activities use up most of any cost savings.
3. Program managers may manipulate decision packages by indicating that spending

reductions will have an unacceptable consequence.