



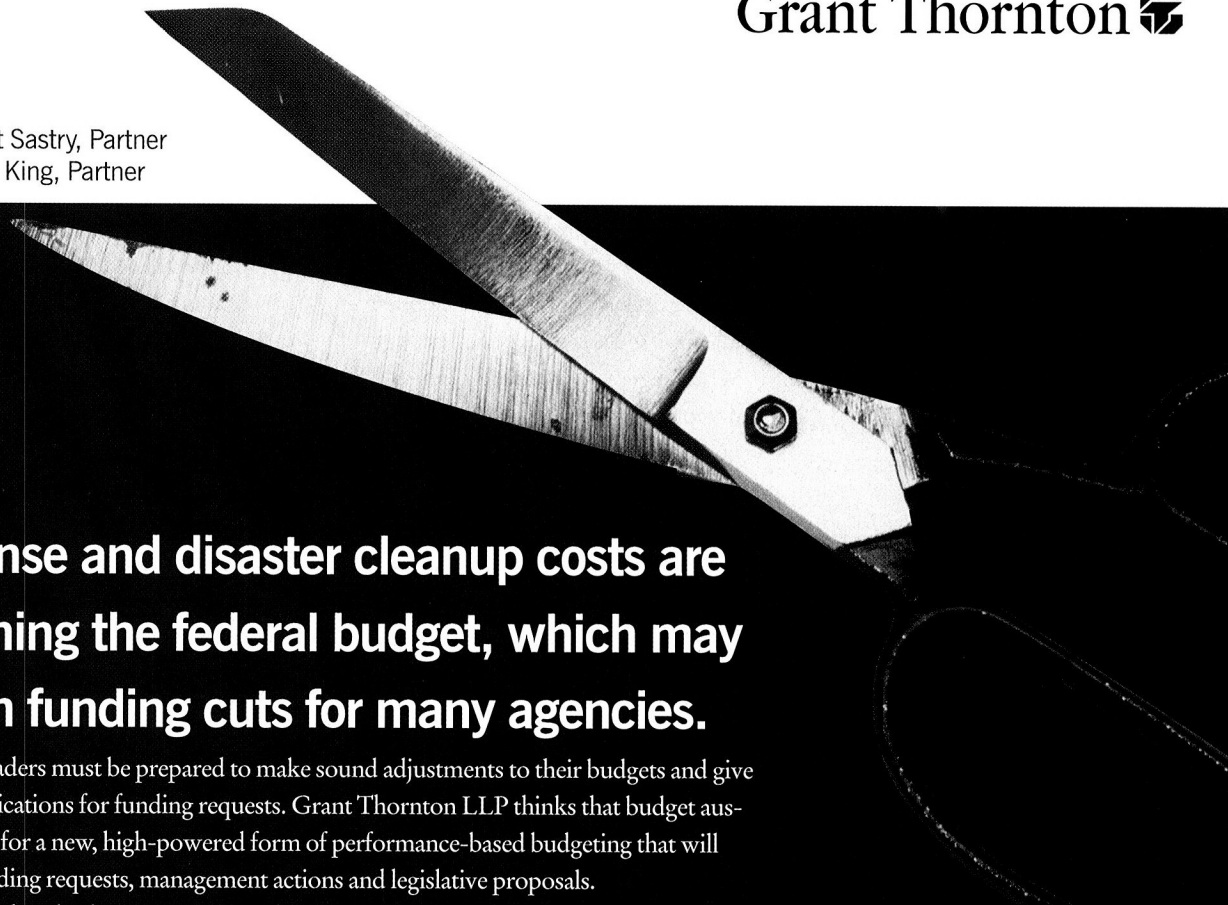
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Competing for funds in austere times: How to win with performance-based budgeting

Grant Thornton 

by Srikant Sastry, Partner
and Scott King, Partner



Defense and disaster cleanup costs are straining the federal budget, which may mean funding cuts for many agencies.

Agency leaders must be prepared to make sound adjustments to their budgets and give solid justifications for funding requests. Grant Thornton LLP thinks that budget austerity calls for a new, high-powered form of performance-based budgeting that will justify funding requests, management actions and legislative proposals.

Given tighter budgets, agencies need ways to get ready for more austere operations. The old way was to make across-the-board cuts to budget and headcount. Now, using performance management and performance-based budgeting (PBB), government executives can easily establish funding scenarios that link an agency's activities to the services it delivers to the public and to outcome goals. As a result, executives can show the affect that an agency has on outcomes and, as a corollary, the impact of budget cuts on those outcomes. With better, integrated performance and budget information, the agency can distribute its funds in ways that will maximize outcomes and overall benefit to the public.

Linking resources to performance

One of the hardest challenges to some agencies is to show how the resources they request cause the outcomes that legislators and the public want to happen. In PBB, outcomes are the results of an organization's outputs; performance goals are the target levels for those outcomes. For example, in Figure 1 below, an environmental agency uses resources (labor and money) to carry out activities (enforcement) that produce outputs (successful prosecution of violators) that contribute to outcomes (measured by the increase in miles of swimmable streams). If the agency sets a target of 500 more miles of swimmable streams a year, then that is one of its performance goals for outcomes.

Figure 1 is a cost assignment view to activity-based costing (ABC), a managerial cost accounting approach used throughout government and industry. Figure 1 provides a simple illustration

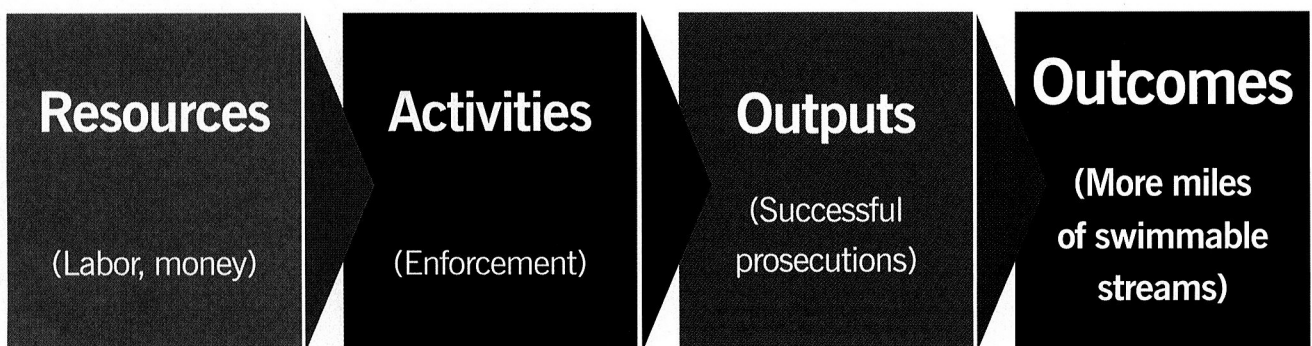
of cost assignment, where outputs and outcomes are cost objects that consume activities, while activities consume resources or costs. In addition to enforcement, the agency may have other outputs that contribute to the outcome of more miles of swimmable streams, such as public education activities like national media campaigns and outreach programs. The sum of the resources flowing into the activities that produce all significant outputs that affect an outcome equals the total cost of that outcome. Financial and program managers typically can manage the delivery of outputs in a cost-effective manner if they understand the underlying costs and activities performed. When aligned appropriately with outcomes, this approach provides a powerful tool to optimize the use of funds for the public good.

This is a simple example and the real world of government budgeting and performance is much more complex. Figure 2 shows a budget and performance management framework of how

the cost assignment concept shown in Figure 1 fits into the complicated field of performance-based budgeting.

In Figure 2, the grey box on the bottom includes the labor and money consumed by the activities and tasks in the box above it labeled "Activity-based Costing" which produce outputs expressed in measurement terms in the box labeled "Link to Performance Budget." For example, workload measures might be the number of citations issued by an enforcement activity or the number of prosecutions undertaken. A performance measure might be the number or percentage of citations and prosecutions resulting in successful prosecutions or settlements in favor of the government. The outputs are consumed by programs, each of which has long-term and annual performance goals and measures. The programs are then consumed by goals and cross-functional processes in the agency's overall operational plan, which affects the attainment of strategic goals and outcomes.

Figure 1: Cost assignment view of links between resources and outcomes



Integrating planning and budgeting

Effective PBB requires integrating planning and budgetary activities so that it is possible to see the affect of different assumptions about funding, demand and other factors. Fortunately, PBB facilitates agency planning and budgeting activities by providing a flexible tool for studying the impact of different goal and cost scenarios. The amount of resources available for activities and tasks influences (or should influence) the setting of program performance and workload measures. If the agency establishes the resource→activity→output→outcome connection shown in Figure 1, then it is possible to use activity models and scenario building to test different budgetary views and assumptions. For example, reducing resources to the activities involved in issuing citations will likely cause a decline in the number of citations issued, which in turn reduces successful prosecutions and settlements and eventually lowers the metric for miles of swimmable streams.

Moving up the levels in Figure 2, an agency can develop similar information for higher-level measures of outcomes. As well, the same information can be re-arranged for different cost objects, such as streams in different states or regions, particular types of enforcement actions or citations issued to certain industries. Flexibility is an important benefit of PBB because the main purpose of this

Figure 2: Agency budget and performance management framework



approach to budgeting is to find out the cost of different levels of outcomes. Knowing the costs, leaders can make informed decisions about where to allocate scarce funding. As important, they can defend those decisions with solid data.

Performance-based budgeting for ongoing management

PBB's flexibility continues throughout a budget period. The same models used to test budget request assumptions can be applied to mid-year corrections based on changes in demand or resources. If major changes occur, their effect on the total budget will be more easily understood with ABC-based budgeting systems.

In addition, there is great power in the concept that managerial cost accounting used by middle managers is the same basic accounting method being applied to the budget.

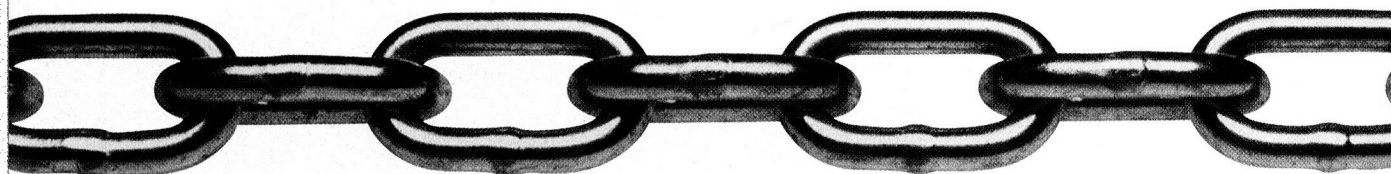
For one thing, the financial and program impact of resource decisions at the lower levels of an organization quickly become visible at the top. Because the resource→activity→output→outcome linkage is clear, middle managers pay more attention to performance goals and require less micromanagement from on high. Moreover, often the same sets of managers are asked to support costing and budgeting programs within the same department. Integrating these efforts helps the managers see the connection between cost, performance and budgets; to better leverage the information to support improved decision-making; and to support the process more efficiently.

One other thing: an ABC-based PBB system can respond quickly to changes in the rules of the game. If an outside organization starts using a new performance measure to judge an agency's accomplishments, then the new measure can be treated as a cost object.

Very quickly, the agency can begin accumulating resource information needed to respond to the new measure.

Linkage is there—effective PBB makes it visible

During the 1960s, someone asked a janitor what he did at a space center. The reply: "I'm putting a man on the moon." In ABC-based PBB, the janitor was right: the Apollo Program that landed the first man on the moon consumed his activity of cleaning the space center. At Grant Thornton, we believe that the ultimate value of ABC-based PBB is its ability to show employees, lawmakers and the public the linkage between resources used and the achievement of agency mission.



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