STATE BAR OF CALIFORNIA

BUDGET PROCESS RECOMMENDATIONS

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Section A: Executive Summary

The State Bar of California ("the Bar") has engaged the services of the Government Finance Officers Association (GFOA) to review its budget processes and make recommendations on how the Bar can further incorporate elements of performance budgeting into its overall budget development process.

This report outlines GFOA's approach to performance budgeting, which is built on programs, performance, and priorities and is informed by its Best Practice on Performance Measures. GFOA also highlights some of the benefits of this approach.

The report also summarizes GFOA's observations of the Bar's budget processes and concludes with recommendations for how the Bar can implement a more performance-based approach to developing and managing its budget.

Section B: What is Performance Budgeting?

Performance budgeting is an approach to developing and managing an organization's budget that considers its performance toward achieving the organization's goals and intended outcomes. Data on performance should be used to guide conversations about the budget and should inform budget decision-making, but it is important to note that performance budgeting is not simply looking at performance measures and increasing the budget in areas of high performance and decreasing it in areas of low performance.

GFOA's Best Practice on Performance Measures recommends that "all organizations identify, track, and communicate performance measures to monitor financial and budgetary status, service delivery, program outcomes, and community conditions." The best practice further recommends that performance measures should "inform decisions and facilitate improvement and understanding" and that "less than favorable outcomes should be evaluated to understand the root cause of the issue." The focus should be on figuring out how to improve outcomes, not on punishing managers.

One of the first steps toward adopting a performance budgeting approach is to develop a program budget. Program budgeting changes the focus of budget discussions and decision-making from departments and their individual line items to programs, defined as sets of related activities directed towards achieving a common purpose or goal. This creates a more transparent budget by showing what the organization does and how much it costs. A program budget is often more meaningful to the governing body and to the public because programs are directly related to how they experience the organization's services.

Figure 1. A Programs-Performance-Priorities Approach to Budgeting

Performance budgeting takes program budgeting a step further by including discussions on program results in the resource allocation decision-making process. In this sense, it can bring the customer's perspective to financial decision-making. One goal of this approach to budgeting is to shift the focus of decision-making from "what should we cut?" to "how can we make the best use of the organization's limited resources?"

Priority-based budgeting is another variation on program budgeting that considers how well-aligned programs are with the organization's strategic priorities. Priority-based budgeting discussions often include conversations about program performance as well. If a particular high-priority program is not performing well, discussion can be focused on uncovering the root causes of the low performance and on exploring alternatives to the existing program (i.e., are there other ways to achieve the intended outcome?).

Increased efficiency is often cited as a benefit of performance budgeting, but it is important to establish a common understanding of goals and intended outcomes before an organization begins measuring efficiency. Without this understanding, the organization could end up measuring efficiency inaccurately. Efficiency is commonly defined as using the least amount of inputs to accomplish a given task, goal, or outcome. In order to gauge the efficiency of a process or program, its goals must be clearly understood. A process could go be re-engineered from five steps to seven steps and still be more efficient, depending on what the goals of the process are. For example, an invoice process could have the singular goal of paying invoices as quickly as possible, or it could have goals that also include ensuring proper approvals are documented in the financial system and recording specific expenditure information in the financial system. In either case, one would measure the efficiency of the process differently.

Performance measures can—and probably should-- evolve over time. Organizations may set performance goals and then discover they need to adjust them, or they may realize that a particular measure is not an accurate or adequate measure of what the organization really cares about. For example, a city manager who does budget training for GFOA tells a story from early in his career when he was working as a performance auditor. He was tasked with auditing the city's process for filling potholes and making recommendations for improvement. At the time, the city's performance goal was to fill a pothole within 48 hours of receiving a resident complaint. As part of the audit, he went out into the field to observe the pothole-filling crews. What he observed led him to realize the City was tracking the wrong measures. Crews would be assigned a list of potholes to fill based on addresses and would focus on those assignments. These assignments were often all over the city, and the crews spent most of their time driving from location to location and spent a small percentage of their time doing the task which added value (filling the potholes). Meanwhile, other potholes in the same vicinity of an "assigned pothole" were not filled because they were not on the list and the crews were very focused on meeting the 48-hour performance target. Since the real desire of the organization was to improve the quality of the roads, his recommendation was to utilize resident complaints to target an area, but the goal would be to fill not just the pothole that was the subject of the complaint, but also other potholes or street imperfections in the vicinity. This would increase potential response time for an individual resident complaint, but it would exponentially increase the number of potholes filled while also reducing the amount of wasted drive time. Ultimately, this would improve the quality of roads (the real goal of the organization), and pre-empt some calls by eliminating what could have been a future complaint.

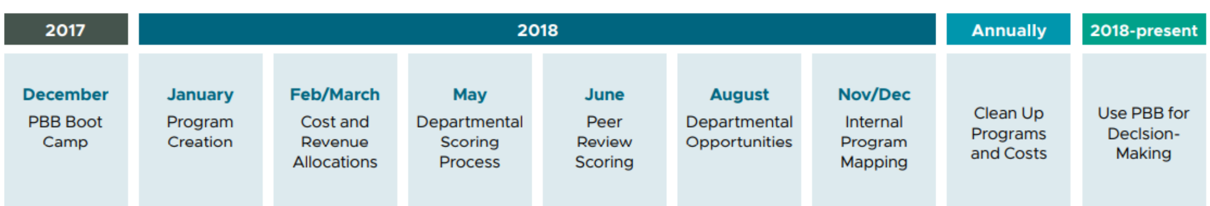
The benefits of taking a programs-performance-priorities approach to budgeting include the following:

- Ensuring that the operations of all parts of the organization are aligned with its mission, vision, and/or strategic priorities
- Facilitating conversation about how the organization can achieve desired outcomes differently and/or more efficiently
- Focusing decision-makers' attention on strategic priorities
- Encouraging innovation and a more collaborative organizational culture

It is important to note that a programs-performance-priorities approach to budgeting is not a panacea for all of an organization's budget problems. This approach does not mean that when faced with fiscal distress, an organization will not need to make cuts to its budget. Budget cuts may still be required, but the expectation is that because the organization has a deeper understanding of its budgeted programs, their performance, and their alignment with its strategic priorities, it can make those cuts in a more strategic way.

As mentioned above, one benefit of a programs-performance-priorities approach to budgeting is that it can spur innovation and facilitate conversation about different ways to achieve an intended outcome. Reducing homelessness is a prime example. There are many different strategies and tactics that governments can employ to address homelessness, including providing job training, mental health services, and housing vouchers, and governments would benefit from monitoring which tactics are most effective. However, the utility of this approach to budgeting may be decreased for programs or services that a government is required to provide in a certain way. If a government is prohibited or constrained from developing program or service delivery alternatives, there is less benefit to be gained from spending time developing innovative approaches. Take Fire Department staffing as an example. A local government may have entered into a collective bargaining agreement that requires a minimum number of firefighters be on duty at all times. Under these circumstances, efforts to develop alternative staffing models as a way to deliver services more efficiently might be moot. Of course, it is always a good idea to review collective bargaining agreements and other documents that impose constraints. Sometimes after review, governments realize they actually have more flexibility than they thought.

While the benefits can be significant, a programs-performance-priorities approach to budgeting is not something than can be implemented overnight. In addition to a strong commitment from executive management, implementation takes time. Jennifer Carlson, the Finance Director for the City of Duluth, MN, shared the City of Duluth's priority-based budgeting (PBB) journey in "[Prioritizing Your Values: Avoiding Slash and Burn in an Economic Downturn]" in the April 2021 issue of *Government Finance Review*. As outlined below, the City started implementation in late 2017 and completed the process a year later. In addition, the City annually reviews programs and costs.



This effort also involved nearly every staff member in the City. The City identified 497 different programs that it operated, and to allocate costs to each program, the City created templates with each department's programs and asked every staff member to fill in the percentage of time they spend working on each program.

Section C: Observations

GFOA reviewed the Bar's 2022 Adopted Final Budget and its 2021 Performance Metrics Report. The Bar compiles performance metrics on a quarterly basis; these are reviewed by the leadership team and presented to the Board quarterly as well.

GFOA also conducted a focus group meeting with employees from across the organization to get a better understanding of the Bar's budget processes and to get a sense of how the budget is viewed by internal stakeholders.

Start with Why

One of the first topics of discussion was the purpose of the budget. GFOA posed the question "why does the Bar have a budget?" to the group. Some of the common themes included:

- Control: The role of the budget is to guide spending. It is important to make sure that managers don't spend more money than what is budgeted. The budget is a means of controlling under-spending and over-spending. Budget controls help highlight if expenses are being charged to the incorrect general ledger (GL) code.
- Accountability: The budget helps provide transparency and accountability. The Bar needs to demonstrate accountability to the State Legislature and to the public. The budget can help demonstrate that the Bar is being fiscally responsible.
- Planning: The budget is a planning tool. Managers need to be able to plan for the future. The budget process should provide an understanding of the financial impact of decisions so there are no surprises down the road. When the unexpected does happen, the budget needs to allow for adjustments.

The Bar's Budget Development Process

GFOA also asked about how the Bar develops its annual budget. The Bar is currently using Microsoft Excel and SharePoint to capture budget requests and develop its annual proposed budget. The State Bar uses an Oracle budgeting system, Planning Budgeting Cloud Service (PBCS), to produce the final budget book. Grants and licensing fees are the Bar's main sources of revenue.

One of the first steps in the process is that Finance schedules meetings with the individual offices to go over budget responsibilities, changes to the process, deadlines, etc. These meetings are held individually with each office.

Another early step is for Finance to create the personnel budgets for each department. Finance reaches out to the departments to identify any personnel-related changes. Based on these conversations, Finance develops a draft personnel budget for each department.

The Office of Access and Inclusion is funded largely by grants, so staff in this office have to track their time by grant. Managers in the Office of Access and Inclusion used this information to refine their personnel budget projections for the upcoming budget year.

Finance relies on the different offices to make most of the changes to the non-personnel portion of the budget, as they know their individual needs better than Finance does. Staff from the different offices explained that they use the current budget and year-to-date spending to inform their non-personnel requests for the upcoming budget year. Other budget expense categories are zero-based and then built up with input from offices. Finance will review each individual line item and see what the historical trend has been for spending in each account and make adjustments as needed.

Challenges Related to the Budget and Budgeting

GFOA asked staff about challenges, frustrations, and pain points related to the budget and the budget development process. Several themes emerged, including:

- Change: The COVID-19 pandemic significantly affected historical trends in revenue and spending. Some areas of the budget are up, and others are down. The Bar, along with most other organizations, must define and then adjust to the "new normal." Due to the upheaval of the past few years, historical data is less useful for making projections than it has been in the past.
- Unpredictable workload: Much of the Bar's work, particularly related to admissions and investigations, is difficult to predict and plan for.
- Balancing expenses and revenue: For the most part, the Bar's revenues, outside of grants, are remaining flat, but costs are increasing. The Bar must request increases to its fees on an annual basis; it has not had a fee increase since 2020 and that was the only fee increase in the past 25 years. In relation to grants, the State's fiscal year is different from the Bar's fiscal year, and the Bar often doesn't find out about new grants until half-way through its fiscal year.
- Complexity: The Bar's different offices undertake very different activities. Developing a budget for an organization that provides such a wide variety of services is complicated and time-consuming. Some staff mentioned that they wished they had more time to develop their budgets.
- Monitoring and reporting: Managers in the different offices mentioned that they cannot easily access budget-to-actual reports throughout the year. Staff cited a need for more timely reports that show revenue and expenses. They stated that they sometimes need to amend their budget during the fiscal year when the mid-year budget review takes place and that having access to more timely reports could help them identify the need for an amendment sooner rather than later. Finance acknowledged that the timeliness of its monthly budget-to-actual reports has been an issue in the past. Finance has made a conscious effort to improve in this area, and in 2022, these monthly reports were issued on time.

Section D: Recommendations

GFOA has developed the following recommendations to help the Bar incorporate programs, performance, and priorities into its budget process. GFOA will conduct training workshops to help the Bar begin implementing these recommendations and has provided links to several case studies in the appendix to show how some of these recommendations could be implemented.

GFOA would like to mention that full implementation of these recommendations is a long-term undertaking. Adopting a program-performance-priorities approach to budgeting should be thought of as an incremental process that would be fully implemented over the next 1-2 years. Given the scope of the project, GFOA believes assigning a staff person to serve as a project manager to coordinate the activities of the different offices would help ensure the ongoing success of this undertaking. GFOA has not conducted a full staffing analysis of the Bar's Finance Office, but given that the Bar currently only has two Finance staff who work on the budget (in addition to other projects), GFOA recognizes that implementing these recommendations could require additional staff resources in the Finance Office.

1. Develop a Program Inventory

As a first step, the Bar should develop a program inventory. Generally, a program is broader than a line item or task, but more detailed than a department or entire function. It can be helpful to think of a program as providing a discrete service that leads to an identifiable result or benefit. A program might reside in one office or department, or multiple departments may be involved in one program. The Bar's cost centers are a helpful starting point for thinking about programs. Many of the existing cost centers are likely programs, but could be combined, while other cost centers may need to be further broken out. For example, cost centers 1120-Group Insurance Program and 1130-Professional Liability Insurance could be combined into a Risk Management program. Meanwhile, it may be useful to break the cost center for the Office of the Chief Trial Counsel into different programs that reflect its responsibilities (i.e., appeals, investigations and trials, calibration and training, criminal conviction matters, etc.).

A program is not:

- A facility or location: A recreation center, airport or golf course is a place, while a program is intended to tell us the activities that go on at that place.
- A line item or operational unit in the organizational chart. Line items are the costs that a program incurs. Operational units are management structures that administer a program.

The following questions can help identify programs:

- Does the Bar advertise a service?
- Is the Bar mandated to provide the service?
- Is someone willing to pay a fee or offer a grant to provide the service?
- Does the Bar offer the service to a particular group or demographic?

2. Assign Costs and Revenues to Programs

Once a program inventory has been developed, the Bar should begin to assign costs to each program. Again, the work the Bar has done to break out its budget into cost centers is a helpful first step toward assigning costs and revenues to programs.

When assigning costs to programs, the Bar should distinguish between recurring and non-recurring costs. Examples of recurring costs include salaries, benefits, insurance, office supplies, and materials. Non-recurring or one-time costs include capital improvements and special projects. Differentiating between cost categories will allow the Bar to estimate a reliable baseline cost for a program. Including one-time costs in the baseline could inflate the perceived cost of a program above what it has been historically.

It's also important to distinguish between personnel and non-personnel costs. Because personnel comprise the vast majority of an organizations costs, just estimating the full cost of the personnel that provide the service will go a long way toward accurately estimating program costs.

An important next step is to associate personnel with the program(s) they provide. An employee might support multiple programs throughout the year, so positions could be divided across more than one program. The Bar might not have records describing how all employees allocate their time to different programs, but a simple survey of the employee or the employee's direct supervisor can be sufficient to get a usable estimate for establishing a baseline.

Once personnel costs are allocated, the next step is to allocate the non-personnel costs to programs. Non-personnel costs are usually a relatively minor component of total program costs, so the Bar does not need to use overly elaborate methods of allocate these costs. It may be sufficient to allocate non-personnel costs based on the number of employees working on the program. What is most important is that the allocation method bear some relation to the actual resources consumed by the program, that it is transparent, and that it is generally regarded as fair.

The Bar should also associate revenues with programs. Taking revenue into account enables conversations about the true cost of providing a service—i.e., the net of the revenues it generates. Costs that are not covered by a program's revenues must be covered by general purpose revenues, and because there is a limit to general purpose revenue, a program's ability to supports its own operations through other sources of revenue is an important budget consideration, though it should not be the only consideration.

3. Review Performance Metrics for Programs

The Bar has developed a robust set of performance metrics and publishes an annual report showing how it has performed on these metrics. After developing its program inventory, GFOA recommends that the Bar review its metrics to ensure that they are providing meaningful feedback on whether or not a program is achieving its goals and intended outcomes. The Bar may determine that many of the metrics it is currently tracking are sufficient, but in other cases, this review may require deeper conversations to clarify who the customer of a particular program is and what specific outcome(s) the Bar is trying to achieve through a particular program.

4. Track Program Costs and Metrics and Conduct Collaborative Budget and Performance Workshops Throughout the Year

GFOA recommends that the Bar track costs by program in addition to tracking metrics by program. Executive staff and program managers should continue to meet as a group regularly throughout the year (possibly monthly or quarterly) to discuss current year budget challenges and program performance. These budget and performance workshops could also be an opportunity to review the Bar's vision, goals, and priorities for the upcoming budget year. These meetings should include staff from throughout the organization and encourage collaboration. The appendix includes links to several case studies on governments that have adopted a similar approach to budgeting.

Appendix: Links to Selected Case Studies, Examples, and Resources

GFOA Best Practice on Performance Measures: Performance Measures (gfoa.org)

Case Study on Northshore School District, Washington, Winner of a GFOA 2022 Award for Excellence Winner for Using Performance Measures to Align the Budget and Pursue Strategic Plan Goals: c3c08c38-9b7b-4dc7-b057-ab55a0fa81fb_northshore-afe2022.pdf (prismic.io)

Case Study on Indian Wells, California and Program Budgeting: https://www.gfoa.org/materials/strategic-planning-program-budgeting-indian-wells

Case Study on Duluth, Minnesota and Priority-based Budgeting: Priority Based Budgeting Creates Community Alignment in Duluth (gfoa.org)

Budgeting by Priorities Example from City of Redmond, WA: Budgets | Redmond, WA

Government Finance Review Article on Redmond's Approach to Budgeting: The City of Redmond: Collaboration and Culture Change (gfoa.org)

Government Finance Review Article on the City of Scottsdale's High Performance and Innovation Team: Collaboration and the City of Scottsdale's High Performance and Innovation Team (gfoa.org)

Government Finance Review Article on Collaboration in the Town of Cary, North Carolina: The Town of Cary Instills a Culture of Collaboration (gfoa.org)

Anatomy of a Priority-driven Budget Process: Anatomy of a Priority-Based Budget Process.qxp (prismic.io)

Government Finance Review Article on Program Budgeting: https://www.gfoa.org/materials/challenges-and-promise-of-program-budgeting-gfr