02: Introduction to Fiscal Health and Wellness through Priority Based Budgeting

Trainer(s):

Jon Johnson, Chris Fabian, & Kathie Novak
Center for Priority Based Budgeting
NLC University Training
Introduction to Fiscal Health and Wellness through PRIORITY BASED BUDGETING (Part I)

Kathie Novak, Jon Johnson & Chris Fabian
March 8, 2014
A Brief Introduction

JON JOHNSON

CHRIS FABIAN
From the Dias ....
Why Fiscal Health and Wellness ?
Historically low interest rates drive pension funding deficits to new lows.

These results build off of the November 2012 Pension Funding Index, forecasting the pension funding status going forward based on a 20% decline in equities in December as a possible market reaction to "falling off the cliff". No changes were made to discount rate or contribution assumptions. Visit www.milliman.com/plf for more details on Millman’s monthly pension funding analysis.

Fiscal Cliff?

Congressional deliberations could drive market volatility.
The U.S. Housing Crisis: Where are home loans underwater?

With U.S. home values falling by nearly 25% since peak in 2007, many homeowners are now underwater in their mortgages, meaning they owe more than their home is worth. Search our interactive map to discover what percentage of homes in your county or ZIP code are in negative equity, based on Zillow's first quarter 2012 data.
Personal Savings Rates Trending Toward 0% – AGAIN!!!
Student Loan Debt - the Next Collapse ????

Household Debt: Student Debt Rising

- Student Loan Debt
- All Other Household Debt

[Graph showing the rise in student loan debt compared to all other household debt from 2008 to 2012.]
So - as an Elected Official:

- What does this mean for me?
- What should I be paying attention to?
- Who should be watching?
- What else is on the horizon?
The Budget ....
From an Elected Officials Perspective
Comparison of Projected Revenues, Outlays, and Deficits in CBO's March 2009 Baseline and CBO's Estimate of the President's Budget

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**EXPENSES**

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Source: Congressional Budget Office
"I'll pause for a moment so you can let this information sink in."
What are your Elected Officials really thinking?

• What does all this financial information really tell me?
  o Are you saying everything is fine?
  o Are you saying we need to make cuts?
  o Are you saying we need to raise taxes?
  o Are you saying we have more money to spend?

• What are you asking me to decide?

  OR

• Are you just wanting my “rubber stamp” of approval?
Are We Headed in the Right Direction?

• “If you don’t know where you are and you don’t know where you are going – any road will get you there.”

• “You've got to be very careful if you don't know where you're going, because you might not get there.” Yogi Berra

- SO -

Show me where we ARE and show me where we are GOING!
The Beginnings ....
Fiscal Health &
Priority Based Budgeting
DOES THIS LOOK FAMILIAR ??????
"States and cities have deep structural problems that will not go away just because the country is coming out of the recession that started in 2008."

"Local governments must stop using budget gimmicks that obscure the true extent of their money problems."

-Volcker-Ravitch Report
Become a Diagnostician

Achieving Fiscal Health & Wellness
Phase I: Initial Diagnosis, Prescription and Treatment Plan

Fiscal Health & Wellness Diagnostic:
- Spending Within Our Means?
- Establishing and Maintaining Our
  - Reserves?
  - Understanding Variances?
  - True Cost of Doing Business?
  - Long-term Decision Making?
- Results of Government?
- Program Valuations?
- Resource Allocation Based on Prioritization?

Prescription of Fiscal Health
Treatment Options to:
- Spend Within Our Means
- Establish and Maintain Reserves
- Understand Variances
- Establish True Cost of Doing Business
- Integrate Long-term Planning into Decision Making

Prescription of Fiscal Wellness
Treatment Options to:
- Sustain Fiscal Health Achievements
- Identify, Define and Value Results of County
- Value Programs (Based on Results)
- Evaluate Program Efficiency
- Support Resource Allocation Decision Making with Program Prioritization
Achieving Fiscal Health & Wellness

2 Strategic Initiatives

Fiscal Health

- Incorporate Economic Analysis and Long-term Planning into Decision Making
- "Spend Within Our Means"
- Transparent About the "True Cost Doing Business"
- Establish and Maintain Revenues
- Understand Variances (Budget vs. Actual)

Fiscal Wellness

- Support Resource Allocation Decision Making with Prioritization of Programs
- Value Programs Based on Evidence of their Influence on Results
- Achieve Fiscal Health
- Identify Programs and Services
- Identify, Define and Value the Results of Government
BRINGING VISION INTO FOCUS
WITH A NEW “LENS”
"Failure to understand financial outcomes is more dangerous to states and localities than ever, and there’s a big gap between what public leaders know about finance and what they need to know."

ICMA
Leaders at the Core of Better Communities

Alliance for Innovation
Transforming Local Government

Best Practice
Straight Ahead

PBB
Center for Priority Based Budgeting
Today’s challenges have required local governments to work differently, looking to new and innovative approaches to service delivery, while at the same time reducing costs and increasing efficiency of operation. While “best” practices are always important for managers to follow and implement, it is those “leading” practices—creative and innovative ways to approach service delivery—that hold the greatest promise for us to truly “reinvent” government and the ways we do business…”

Robert O’Neill, Executive Director, International City/County Management Association (ICMA)
CPBB Publications on Fiscal Health & Wellness
Achieving Fiscal Health

-OR-

Confessions of a 30-year Finance Director!
AC HIEVING FISCAL HEALTH

Incorporate Economic Analysis and Long-term Planning into Decision Making

"Spend Within Our Means"

Fiscal Health

Transparent About the "True Cost Doing Business"

Establish and Maintain Revenues

Understand Variances (Budget vs. Actual)
Strategic Questions

1. How much do we have available to spend? - (not “How much do you need”?)
Approach to Fiscal Health #1: “Spend Within Your Means”

Apply Diagnostics - **DO YOU...**

- **Start with revenues?**
  - Know what “drives” each major revenue source?
  - Prepare a formal organization-wide **Revenue Manual**?

- **Distinguish one-time from ongoing sources and uses?**
  - Have a process in place to “track” them separately?
  - Demonstrate this differentiation in your forecasts and other financial documents?

- **Differentiate Program Revenues from General Government Revenues?**
  - Adjust budget allocations to departments for changes in associated Program Revenues?
### EXECUTIVE SUMMARY

#### GENERAL FUND

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Approach to Fiscal Health #1: “Spend Within Your Means”

Available Treatments:

- **Achieve ongoing alignment**
  - Fund operating expenditures with reliable ongoing revenues
  - Prevent reliance on volatile revenues (that might not come in!)

- **Achieve one-time alignment**
  - Fund one-time costs with one-time sources
  - Ensure reserves aren’t used for ongoing expenses

- **Promote revenue diversification and enhancement**
**Strategic Questions**

1. How much do we have available to spend? - *(not “How much do you need”?)*

2. Why do we need to keep “money in the bank”?
Approach to Fiscal Health #2:
Establish and Maintain Reserves

Apply Diagnostics - **DO YOU...**

- **Understand what makes up Fund Balance(s) and why you hold reserves?**
  - Have a formal "inventory" of all restricted or designated fund balance reserves, stating their purpose, the authority establishing them and how they are to be calculated?

- **Have a written fund balance reservation policy?**
  - Monitor fund balances to ensure that reserves are maintained?
  - Ensure established working capital reserves are sufficient to meet emergency needs or short-term revenue shortfalls?

- **Monitor Fund Balance levels to ensure they “aren’t too little” OR “too much”, but “just right”?**
Determining the “Right” Level

- Baseline recommendation (General Fund) –
  - 5% to 15% of operating revenue
  - 1 to 2 months operating expenditures

- Adjust for:
  - Historic Events and Past Experience
  - Government Size
  - Revenue Stability
  - Future Capital Needs
Standard & Poor's Views

- **Low** = 0% or “below”
- **Adequate** = 1% to 4%
- **Good** = 4% to 8%
- **Strong** = 8% to 15%
- **Very Strong** = Above 15%
Approach to Fiscal Health #2: Establish and Maintain Reserves

Available Treatments

- Establish a written Working Capital/Emergency Reserve policy
  - Provides back-up plan for emergencies, revenue shortfalls, or other unforeseen changes

- Identify, document and understand all reserves

- Review adequacy of Fund Balance levels
  - Hold only appropriate amount in reserve to establish credibility with internal and external stakeholders

- Set aside funding for long-range plans, major maintenance and asset replacement
Strategic Questions

1. How much do we have available to spend? - (not “How much do you need”?)
2. Why do we need to keep “money in the bank”?
3. What’s the “difference”? 
Approach to Fiscal Health #3: Understand Variances

Apply Diagnostics - **DO YOU**...

- Include **cyclical** (one-time) expenditures in ongoing operating budgets?
- Allow Departments to budget for contingencies?
- Consistently have revenue/expenditure variances at year-end?
  - Overlook thorough analysis of budget-to-actual variances?
- Count on “savings” resulting from budget-to-actual variances?
- Have large capital project “carry-forwards” at year end?
Approach to Fiscal Health #3: Understand Variances

Available Treatments:
- **Strive to align budget with actuals (a source of “hidden treasure”)**
  - Refine salary and benefit projections, to align with actual costs incurred
  - Provide more effective budget monitoring and management to eliminate variances
  - Identify and eliminate the “fluff”
- **Fund cyclical expenditures with one-time funding sources**
- **Consolidate contingencies maintained in department budgets**
- **Analyze and understand revenue variances**
- **Promote multi-year budgeting for capital projects**
Strategic Questions

1. How much do we have available to spend? - (not “How much do you need”?)
2. Why do we need to keep “money in the bank”?
3. What’s the “difference”?
4. “It costs how much”?
Approach to Fiscal Health #4:

**Transparent About “True Cost of Doing Business”**

Apply Diagnostics - **DO YOU...**

- Allocate overhead and administrative costs to Funds and/or Departments that benefit from those services?
- **Utilize Internal Service Funds to align delivery and cost of internal services with customer demand?**
  - Know what services are best adapted to an Internal Service Fund approach?
  - Understand how internal charges are established and distributed?
  - Ensure that internal customers perceive that costs are transparent and there is an ability to influence those costs by altering their own demand?
Approach to Fiscal Health #4:  
**Transparent About “True Cost of Doing Business”**

**Apply Diagnostics - DO YOU...**

- **Identify total cost (direct AND indirect) for all programs?**
  - Prepare a [Full Cost Allocation](#) plan in addition to an [OMB A-87 Cost Allocation Plan](#)?
  - How is this [Plan](#) incorporated into the budget process?

- **Establish fees for service that recapture appropriate level of total costs of providing that service?**
Approach to Fiscal Health #4: 
**Transparent About “True Cost of Doing Business”**

Available Treatments:

- **Establish Internal Service Funds and engage Departments in assessing demands for these services**
- **Promote enhancement of cost recovery for programs where appropriate**
- **Diversify cost burden from General Fund by appropriately sharing costs among other dedicated revenue streams**
- **Inventory and cost all programs**
  - Utilize Full Cost Plans to better determine the true cost (direct and indirect) of offering programs/services
Strategic Questions

1. How much do we have available to spend? - (not “How much do you need”?)
2. Why do we need to keep “money in the bank”? 
3. What’s the “difference”? 
4. “It costs how much”????????
5. “What’s the plan” and what could cause it to change?
6. What does the future look like? 
7. “What if………..”???
Apply Diagnostics - **DO YOU...**

- Incorporate **ALL** long-term plans developed within the organization into your financial forecasts?

- Prepare comprehensive, multi-year Capital Improvement Plan, and clearly identify associated ongoing operating costs?
  - Understand how the CIP impacts the budget process and your long-term financial forecasts?

- Identify only relevant economic indicators to monitor?

- Effectively utilize appropriate “tools” to communicate financial position to all stakeholders (elected officials, citizens and staff)?
Approach to Fiscal Health #5: 
**Economic Analysis & Long-term Planning**

**Available Treatments:**

- **Prepare a 5 to 10 year financial forecast**
  - Use relevant key indicators and trend analysis to improve decision-making
  - Update and present on regular basis throughout the year
  - Identify potential points of failure and plan for needed changes

- **Utilize simple, graphic communication tool to illustrate fiscal health position to all stakeholders**
  - Keep decision makers focused on high-level stewardship role
  - Access impact of “today’s” decisions on future financial sustainability
  - Allow scenario-planning which encourages flexible and adaptive decision-making
Looks like a Financially “Healthy” Organization – Right?
Let’s Look through a Different Lens!

CITY OF WHEAT RIDGE, COLORADO
COMBINED GENERAL and CAPITAL FUNDS
Wednesday, May 15, 13

Fiscal Health Diagnostic (Are objectives met?)

<table>
<thead>
<tr>
<th>Objectives</th>
<th>Status</th>
<th>1st Year Missed</th>
<th>1st Year Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>Set Aside Reserves</td>
<td>Meets</td>
<td>-</td>
<td>$0</td>
</tr>
</tbody>
</table>

Achieve “Ongoing” Alignment

| Does Not Meet | 2014 | ($137,866) |

Achieve “One-time” Alignment

| Meets | - | $0 |

Note: Items in "Blue" can be modified; items in "Black" can not

Additional Ideas for Revenue Enhancement

<table>
<thead>
<tr>
<th>Description</th>
<th>R</th>
<th>Ongoing</th>
<th>Year 1</th>
<th>Year 2</th>
<th>One-Time</th>
<th>Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase Sales Taxes</td>
<td>R</td>
<td>0</td>
<td>2014</td>
<td>2017</td>
<td>0</td>
<td>2013</td>
</tr>
<tr>
<td>Sell City Hall (sell assets)</td>
<td>R</td>
<td>0</td>
<td>2014</td>
<td>2017</td>
<td>0</td>
<td>2014</td>
</tr>
<tr>
<td>ULTIMATE ELECTRONICS CLOSES</td>
<td>R</td>
<td>0</td>
<td>2014</td>
<td>2017</td>
<td>0</td>
<td>2012</td>
</tr>
<tr>
<td>Anticipated Increase In Sales Tax Revs</td>
<td>R</td>
<td>0</td>
<td>2015</td>
<td>2017</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Fill Gap</td>
<td>N</td>
<td>2014</td>
<td>2015</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adjust Reserve Policy</td>
<td>N</td>
<td>10%</td>
<td>2013</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Ongoing Alignment

<table>
<thead>
<tr>
<th>Ongoing Revenues</th>
<th>Ongoing Expenditures</th>
</tr>
</thead>
<tbody>
<tr>
<td>$31,000,000</td>
<td>$15,000,000</td>
</tr>
<tr>
<td>$29,000,000</td>
<td>$13,000,000</td>
</tr>
<tr>
<td>$27,000,000</td>
<td>$12,000,000</td>
</tr>
<tr>
<td>$25,000,000</td>
<td>$11,000,000</td>
</tr>
<tr>
<td>$23,000,000</td>
<td>$10,000,000</td>
</tr>
<tr>
<td>$21,000,000</td>
<td>$9,000,000</td>
</tr>
<tr>
<td>$19,000,000</td>
<td>$8,000,000</td>
</tr>
<tr>
<td>$17,000,000</td>
<td>$7,000,000</td>
</tr>
<tr>
<td>$15,000,000</td>
<td>$6,000,000</td>
</tr>
</tbody>
</table>

One-time Alignment

<table>
<thead>
<tr>
<th>Year</th>
<th>Fund Balance &amp; One-time Revenue</th>
<th>One-time Expenditures</th>
<th>Reserve Policy</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>$17,500,000</td>
<td>$7,500,000</td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td>$15,000,000</td>
<td>$5,000,000</td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td>$12,500,000</td>
<td>$2,500,000</td>
<td></td>
</tr>
<tr>
<td>2012</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

One-time Projects

<table>
<thead>
<tr>
<th>Y/N</th>
<th>Approve Year</th>
<th>First Yr $</th>
</tr>
</thead>
<tbody>
<tr>
<td>N</td>
<td>2013</td>
<td>$</td>
</tr>
<tr>
<td>N</td>
<td>2013</td>
<td>$</td>
</tr>
<tr>
<td>N</td>
<td>2014</td>
<td>$</td>
</tr>
<tr>
<td>N</td>
<td>2014</td>
<td>$</td>
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<tr>
<td>N</td>
<td>2015</td>
<td>$</td>
</tr>
<tr>
<td>N</td>
<td>2015</td>
<td>$</td>
</tr>
<tr>
<td>N</td>
<td>2016</td>
<td>$</td>
</tr>
</tbody>
</table>

CIP - 32nd Ave. Reconstruction - Wadsworth to Kipling
CIP - Wadsworth Reconstruction - 39th to 46th
CIP - Pedestrian & Bike Master Plan
CIP - Dispatch Center

$15,000,000

### Fiscal Health Diagnostic Tool

**GENERAL FUND**

Monday, June 08, 2009

#### Fiscal Health Diagnostic (Do we meet the objectives?)

<table>
<thead>
<tr>
<th>Objectives</th>
<th>Status</th>
<th>1st Year Missed</th>
<th>1st Year Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>Set Aside Reserves</td>
<td>Meets</td>
<td></td>
<td>$0</td>
</tr>
<tr>
<td>Fund &quot;True Cost of Business&quot;</td>
<td>Meets</td>
<td></td>
<td>$0</td>
</tr>
<tr>
<td>Achieve &quot;Ongoing&quot; Alignment</td>
<td>Does Not Meet</td>
<td>2010</td>
<td>($1,492,879)</td>
</tr>
<tr>
<td>Achieve &quot;One-time&quot; Alignment</td>
<td>Meets</td>
<td></td>
<td>$0</td>
</tr>
</tbody>
</table>

(Key: Items in "Blue" can be modified; items in "Black" can not)

#### Ideas for Cost Containment or Additional Revenue

<table>
<thead>
<tr>
<th>Description</th>
<th>R/E</th>
<th>Ongoing</th>
<th>Year 1</th>
<th>Year n</th>
<th>One-time</th>
<th>Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Raising Taxes</td>
<td>R</td>
<td>$1,500,000</td>
<td>2007</td>
<td>2012</td>
<td>$0</td>
<td>2009</td>
</tr>
<tr>
<td>Use FB for Ongoing</td>
<td>N</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>2010</td>
</tr>
</tbody>
</table>

#### Ongoing Business Cases

<table>
<thead>
<tr>
<th>Ongoing Projects</th>
<th>Y/N Approval Year</th>
<th>First Year $</th>
</tr>
</thead>
<tbody>
<tr>
<td>Detention Center Expansion</td>
<td>Ongoing Impacts</td>
<td>Y 2009  $760,000</td>
</tr>
<tr>
<td>Sheriff's PC Replacement</td>
<td>Ongoing Impacts</td>
<td>Y 2009  $35,232</td>
</tr>
<tr>
<td>Assessor System</td>
<td>Ongoing Impacts</td>
<td>Y 2009  $316,046</td>
</tr>
<tr>
<td>Treasurer's System</td>
<td>Ongoing Impacts</td>
<td>N 2009  $-</td>
</tr>
</tbody>
</table>

#### One-time Business Cases and 5-Year Plan

<table>
<thead>
<tr>
<th>One-time Projects</th>
<th>Y/N Approval Year</th>
<th>First Year $</th>
</tr>
</thead>
<tbody>
<tr>
<td>Detention Center Expansion</td>
<td>Y 2009</td>
<td>$3,500,000</td>
</tr>
<tr>
<td>Sheriff's PC Replacement</td>
<td>Y 2009</td>
<td>$440,400</td>
</tr>
<tr>
<td>Assessor System</td>
<td>Y 2009</td>
<td>$3,950,580</td>
</tr>
<tr>
<td>Treasurer's System</td>
<td>N 2009</td>
<td>$-</td>
</tr>
</tbody>
</table>

#### Ongoing Alignment, 2008-2012

<table>
<thead>
<tr>
<th>Year</th>
<th>Ongoing Revenues</th>
<th>Ongoing Expenses</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>$130,000,000</td>
<td></td>
</tr>
<tr>
<td>2009</td>
<td>$140,000,000</td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td>$150,000,000</td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td>$160,000,000</td>
<td></td>
</tr>
<tr>
<td>2012</td>
<td>$170,000,000</td>
<td></td>
</tr>
</tbody>
</table>

#### One-time Alignment, 2008-2012

<table>
<thead>
<tr>
<th>Year</th>
<th>One-time Sources</th>
<th>One-time Expenses</th>
<th>Reserve Policy</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>$60,000,000</td>
<td>$20,000,000</td>
<td></td>
</tr>
<tr>
<td>2009</td>
<td>$40,000,000</td>
<td>$10,000,000</td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td>$20,000,000</td>
<td>$5,000,000</td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td>$10,000,000</td>
<td>$2,500,000</td>
<td></td>
</tr>
<tr>
<td>2012</td>
<td>$5,000,000</td>
<td>$1,250,000</td>
<td></td>
</tr>
</tbody>
</table>
Live Demonstration of

“Fiscal Health Diagnostic Tool”
Diagnostic Questions to Ask

Does your organization differentiate between ONE-TIME and ONGOING revenues and expenditures?
   If yes, how are they tracked? Does your forecast demonstrate this differentiation?

How does your organization differentiate “program” revenues from “enterprise” revenues such as taxes, earnings on investments, franchise fees, etc.?

Does your organization prepare a formal Revenue Manual?
   If yes, what type of information is included?
Diagnostic Questions to Ask

Does your organization have a written fund balance reservation policy?

If yes, how are you monitoring those reserves to ensure that they are properly and adequately maintained?

Are established working capital reserves sufficient to meet emergency needs or short-term revenue shortfalls?

Does your organization have an inventory of all restricted or designated fund balance (reserves)?

If yes, does it indicate the purpose for the reserve, cite the authority for its establishment and show how it is calculated?
Diagnostic Questions to Ask

Are variances between budgeted and actual revenues and expenditures analyzed and explained?
   If yes, how do those variances impact future budget cycles?

Does your organization utilize a formal Compensation Plan to establish employee salary/wage ranges?
   If yes, how often is the plan updated?

When assessing the adequacy of employee compensation, are employee benefit packages included in this assessment?
Diagnostic Questions to Ask

Does your organization utilize Internal Service Funds?

If yes, what are the services provided by each fund and how are internal charges established and distributed?

Are appropriate demand metrics evaluated when determining how internal charges are to be assessed or distributed?

Do internal customers perceive that the calculation and assessment of those internal charges is transparent and that they can influence those charges by altering their own demand?

Does your organization prepare a Full Cost Allocation plan in addition to an OMB A-87 Cost Allocation Plan?

If yes, how is this plan incorporated into the budget process?
Diagnostic Questions to Ask

Does your Five-Year forecast incorporate ALL other long-term plans developed by your organization?

Does your organization prepare a Capital Improvement Plan (CIP)?
   If yes, what information is included and how is it utilized in your budget process and your financial forecasts?

What tools does your organization use to communicate financial information to its elected decision-makers?
Thank You!

CENTER FOR PRIORITY BASED BUDGETING
Using a Unique Lens to Focus Community Resources on Results

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