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**Improve Government
Budgeting With a
Performance-Based
Approach**



Government CFOs must modify their budgeting practices to meet shifting funding priorities and a growing emphasis on transparency. This research provides guidance on integrating performance-based budgeting techniques with legacy budgeting practices to better align resources with desired outcomes.

Overview

Key findings

- Government CFOs' reliance on historical actuals in their budgeting process risks poor alignment of public funds to future priorities or needs.
- Legacy budgeting practices using prior-year funding as a baseline result in project funding being set at similar levels year after year regardless of performance.
- When facing budget challenges, government CFOs apply budget cuts equally across all departments rather than allocating resources to areas with the most strategic alignment and highest performance.
- Budget owners are often reluctant to implement a new budgeting methodology.

Recommendations

To implement performance-based budgeting to improve their use of public funds, government CFOs should:

- Prioritize spending by identifying strategic and departmental priorities.
- Strengthen the criteria by which funding decisions are made by setting clear priority-aligned performance metrics and targets.
- Limit the impact of budget cuts on quality by adjusting funding levels by performance outcome.
- Win buy-in for the new budgeting approach by involving budget owners early and communicating often throughout.

Strategic Planning Assumption

By 2028, 65% of government organizations will meet the growing demand for transparency and accountability by utilizing performance outcomes in their budgeting process.

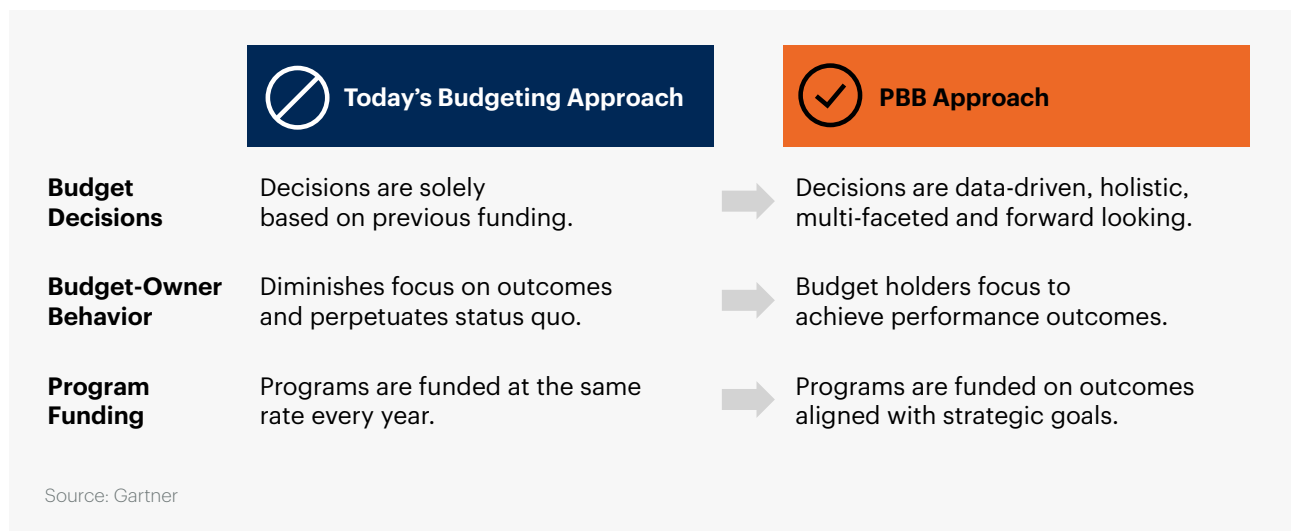
Introduction

Many government CFOs rely heavily on historical actuals to develop their budget, but with ongoing budget constraints and increased expectations to show outcomes, government CFOs are evaluating their current budgeting methodology. Relying on legacy budgeting practices, such as historical actuals, can result in misaligned budgets where the same programs receive the same levels of funding year after year. This increases the risk of budgeting challenges that can delay key strategic initiatives, such as technology investments. Government CFOs must look beyond historical actuals to prioritize their spending in order to meet current and future funding needs.

Performance-based budgeting (PBB) is the allocation of funding based on program outcomes that contribute to the overall organizational goals. This approach integrates data and evidence to improve how resources are distributed throughout the budgeting process.

How can government CFOs ensure their budgeting practices continue to meet organizational needs amid rapidly shifting priorities? PBB offers a more in-depth and well-rounded decision-making framework compared to today's typical one-dimensional budgeting approach (see Figure 1). This research teaches how to implement PBB by identifying strategic and departmental priorities, setting performance metrics, budgeting by performance outcome and driving cultural change to shift budget-owner behavior and engage budget owners in the budgeting process.

Figure 1: Benefits of Adding Performance-Based Budgeting (PBB)

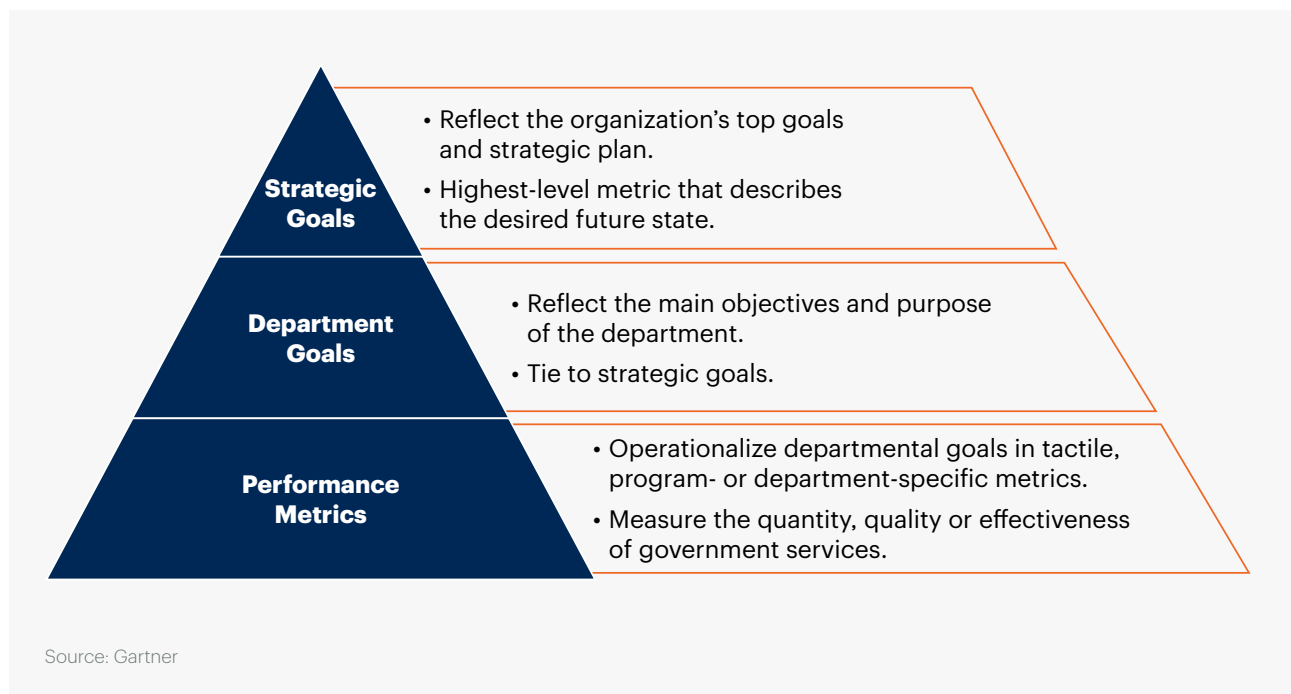


Analysis

Identify Strategic and Departmental Priorities

To fully implement PBB, government CFOs must have a clear understanding of their organization's strategic goals. This first step in the performance metric hierarchy is vital in determining if the selected performance measures are effectively moving the organization toward its intended direction. Departmental goals must also be developed to operationalize those strategic goals and tie into performance metrics (see Figure 2).

Figure 2: Identifying the Performance Metric Hierarchy



Strategic Goals

Identifying and understanding strategic goals is the outcome of an organization's strategic planning process. The organization should also have a well-designed strategic planning and review process to ensure organizational goals remain relevant and meet citizens' most pressing needs. Strategic goals are developed by the seniormost leadership at the organization by considering:

- The purpose of the organization and the purpose it serves to citizens
- The desired future state of the organization
- Whether the goal is actionable
- Whether qualitative or quantitative progress on the goals can be measured

Sample government strategic goals:

- Provide access to high-quality and affordable healthcare.
- Protect and manage natural resources.
- Provide economic opportunity and affordability.
- Promote a sustainable environment.
- Create a safe transportation system focusing on ease of access.

Department Goals

Departmental goals tie to one or more of the strategic goals of the organization. They must reflect a service or purpose and are often focused around the improvement of service delivery or enhanced ways of meeting outcomes. Departmental goals set the tone for accountability and transparency, and improve communication outside of the department.

When developing departmental goals, first assess departmental strengths, weaknesses, opportunities and threats (SWOT). Information obtained from the SWOT analysis should be worked through a prioritization framework that weighs the most important opportunities and necessary improvements for the department. There are typically more departmental goals than strategic goals, but the list should not become so exhaustive that tracking is impaired. If you are new to tracking departmental goals, start with a smaller list of goals and perfect the tracking/reporting processes prior to adding more.

Sample government departmental goals:

- Provide excellent, timely and cost-effective customer service.
- Provide service based on best practices and fiscal sustainability.
- Digitize financial processes to maximize efficiency.
- Provide effortless payment options to the public.
- Provide effective leadership and development opportunities to all staff.

Set Performance Metrics and Targets That Align With Priorities

Once government CFOs have clarity on strategic and department-level goals, the next step for implementing PBB is to identify key performance metrics for each program at the department level. It is important that each performance metric clearly aligns both with strategic government and department-level goals. Decision makers across government will then use these key performance metrics to ensure expenditures take into account results and deliverables, rather than continuing to fund at the same historical levels. In many cases, performance metrics are already available and being tracked by departments for other purposes in the form of activity metrics.

Various forms of performance metrics can be used. The most-used metrics focus on output or timeliness and provide insight into how much a given department or initiative accomplishes. Outcome-based metrics are used to quantify if an outcome has been met. Other useful performance metrics include those that measure quality, such as customer service, and those that measure efficiency.

Sample Performance Metrics

Output/Timeliness

- Number of purchase orders processed
- Number of help desk tickets closed
- Number of residential permits issued
- Number of people served
- Average time to process an invoice

Customer Service

- Average time customers are on hold before speaking to a representative
- Number of inquiries solved in the first interaction
- Customer service scores

Efficiency

- Number of departmental processes digitized
- Number of departmental spreadsheets eliminated through dashboards
- Number of departmental reports eliminated through utilization of technology

Sample Outcome-Based Metrics

- The smoking cessation rate (to track the effectiveness of various public smoking cessation programs)
- The recidivism rate (to track the effectiveness of supervision and educational programs)
- Seat-belt compliance (to track the effectiveness of educational, public health and law enforcement initiatives)

In order for performance metrics to be effective, each program will need a detailed understanding of what is being measured. When developing your metrics, determine how performance data will be tracked and reported, and how resource allocation will be tracked over time. When beginning, three to four metrics per program area is sufficient. Metrics are only one measure of operational effectiveness and should be examined alongside budget allocation to ensure expenditure is greatest where it has the greatest impact.

Budget Using Performance Outcomes

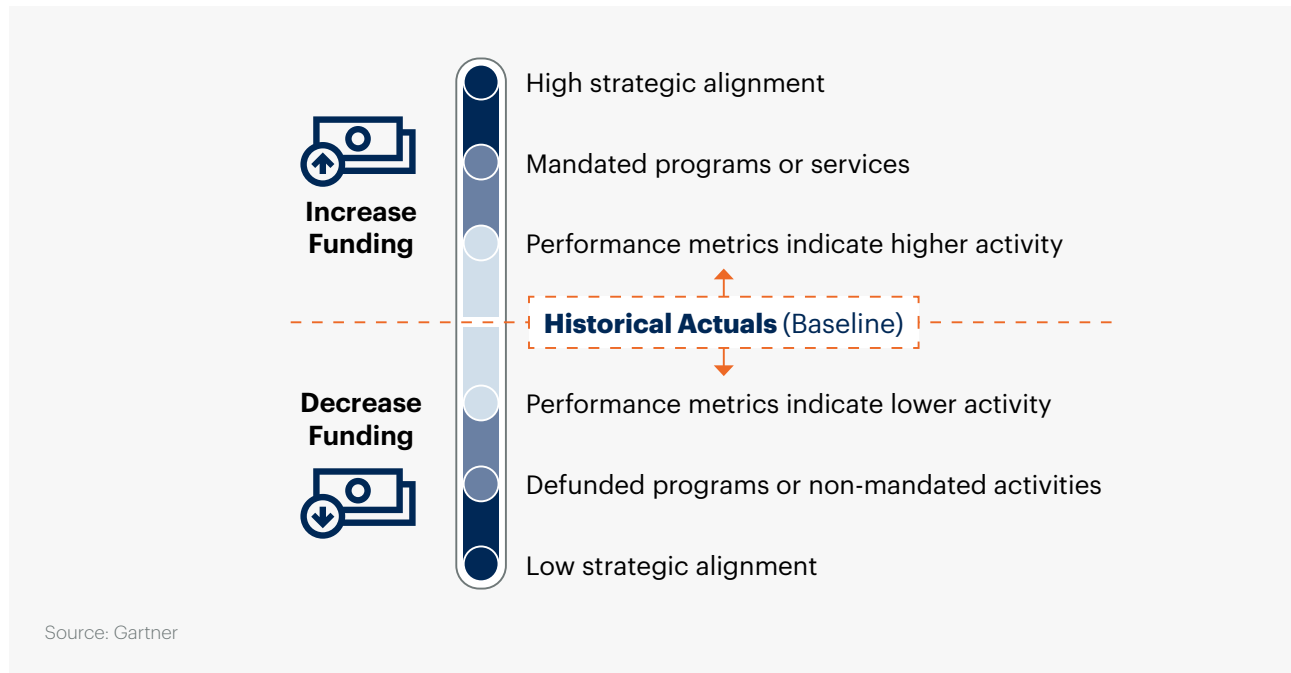
When deciding on budget allocation, strategic goals, departmental goals and performance metrics must be reviewed comprehensively across the agency, not just by program or department, to ensure continuity and forward-thinking are applied to every budget decision. To effectively implement PBB, the budget preparation process must be carefully designed and include a comprehensive expenditure review. This review should incorporate performance metrics to assess program effectiveness and outputs, and identify areas where reductions, eliminations or expansions may be necessary.

It is important to note that historical actuals help inform budget decisions. However, by adding performance measures, CFOs can strengthen those decisions and align budget allocation with the performance goals and outcomes of a given area. While some government CFOs use PBB as an exclusive budget practice, Gartner recommends integrating performance-based budgeting into the existing approach to drive budget decisions beyond historical actuals.

Increase or Decrease Funding by Evaluating Performance Results

To implement PBB in the budgeting process, the historical funding levels and previous actuals should be used as a baseline. To determine if the budget should be adjusted up or down, performance metric results should be analyzed against other budgetary considerations such as new mandates (see Figure 3). Adding PBB should not be a system of rewards and punishments. If a performance decline is noted, a systematic approach of determining the reason for the decline is imperative, rather than an immediate decrease in funding. On the contrary, adding resources to a specific area should consider all factors including technology, process improvements and long-term plans for the department.

Figure 3: Implementing Performance-Based Budgeting Through Funding Levels



For example, a local government sees a drastic spike in building permits over two years and wants to add five additional planning staff. Its budget decisions should be based on more than just the building permit numbers. The organization must also consider other factors, such as new technology implemented to address permitting, trends in building and how long the higher numbers are anticipated, and areas for process improvement that don't involve increased staff. This thorough approach, which uses performance data, provides a multidimensional perspective to ensure funding is added or omitted in the appropriate areas.

Prioritizing New Funding Using PBB

Any new or proposed funding in the budget development process must include an evaluation and prioritization framework that addresses which strategic goal the spending ties into and how performance will be tracked. Performing this exercise annually during early stages of budget review is important to ensure alignment between departmental goals and strategic goals. This helps budget owners broaden their perspective beyond siloed budgeting and align departmental objectives with organizational strategy.

Government CFOs should do this through a business case template that requires the department to:

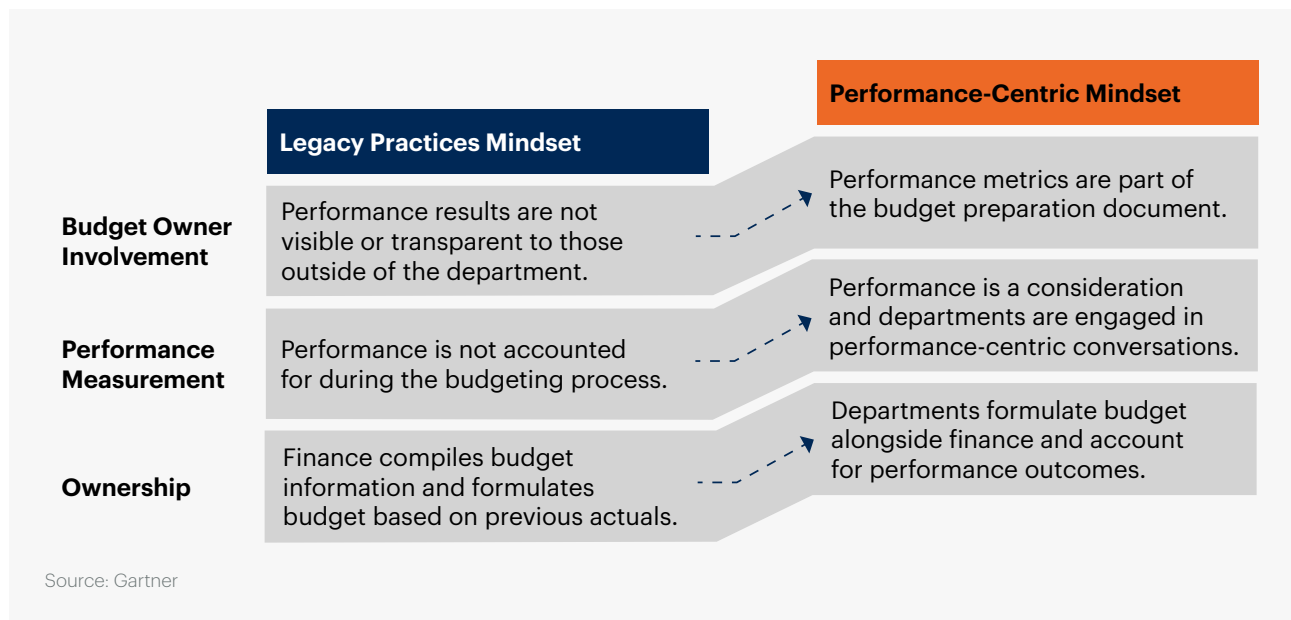
- Address the alignment to mission and strategic goals.
- Lay out long-term cost over time.
- Clearly state what mandate the new funding addresses.
- Describe how risk will be mitigated through the new funding.
- Describe the current state and proposed future state.
- State who the key stakeholders are in the management of the performance metrics,

Adding PBB takes time, and its long-term results will not be seen in just one year. For many organizations, it takes multiple budget cycles to see the results of adding PBB. If your organization finds its performance indicators are not a good representation of activity, consider revising your performance metrics. Revision of the metrics should not be done haphazardly or midway through a budget cycle.

Shift the Budgeting Mindset

A critical success factor for PBB is ensuring there is budget owner buy-in for the new approach. Government CFOs often meet resistance when proposing a new way of doing things, especially by those who have engaged in the same budgeting techniques for many years. To shift from a legacy-practices mindset to a performance-centric mindset, change management plays a vital role (see Figure 4). Cultural shifts take time, and buy-in cannot be expected to happen immediately.

Figure 4: Shifting to a Performance-Centric Mindset



Government budgeting is typically a one-sided conversation driven by the CFO and the budget office. Budget owners are often told what they need to cut in order to keep funding at current levels or adapt to changing mandates. Departments often feel like they don't have a voice in developing the budget around their priorities and develop a short-sighted approach, only looking at their activities annually. This can lead to poor ownership and lack of accountability.

To begin to shift the culture to be more accepting of performance metrics' use in the budgeting process, CFOs should:

- Involve budget owners early — Ensure budget owners have opportunity to provide input on the performance metrics for their program area. This involvement can be done formally through workgroups or informally through meetings between finance and the program/department. Finance must follow through with consistent updates to the program/departments via quarterly updates on budget to actuals and performance metrics.
- Communicate performance outcomes clearly and often — Take time to explain the value of the methodology (“why”) and how performance standards help demonstrate what taxpayers receive for their money. Government CFOs can't assume budget owners will understand the value of this budgeting approach, so should explain that the approach should shift from, “Where can we cut costs?” to “Where should we keep spending and why?” Dashboards can be a productive way to communicate with budget-owners in real time and allow them to own their results, rather than wait for a quarterly meeting to discuss them.
- Shift Ownership — CFOs must allow the department to own its performance metrics by having department heads present their metrics to stakeholders and describe any patterns or changes. Government CFOs must provide a framework for budget owners to enhance programs and services in response to performance metrics. They must also facilitate an environment of open communication, so any budget reallocations as a result of performance aren't viewed as failures, but rather are looked at as an evolving way of meeting strategic goals.

Next Steps

- Ask yourself what the three main strategic objectives are for your organization. Do you have strategic and departmental goals that represent these objectives?
- Involve budget owners by brainstorming performance metrics at the department level that could serve as a basis to inform budget decisions.

Evidence

This analysis is based on analyst experience while working with Gartner clients and other innovative organizations. It is also based on analyst discussions and numerous dialogues with major industry participants.

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