

The Budget: An Organization's Most Important Planning Tool

PLAN 524: Advanced Strategic Planning
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- Most of us think of a budget as a listing of projected costs and expenses.
- One simple form of budgeting is the "line item" budget, which does list general categories and dollar figures.

What is a Budget?

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- In reality, a budget is a planning tool and a planning document, perhaps the most important one available, if it is used properly throughout the organization.
- A budget is an especially important tool for assessment and Strategic Planning!!!

What is a Budget?

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- Aaron Wildavsky was one of the pioneers of budgeting, an organizational theorist who explored the nature and extent of the budget within government and other organizations.
- Wildavsky give the following framework for definitions and understanding the budget in one of his “classic” books on budgeting in the following slides.

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- *In the most literal sense, a budget is a document, containing words and figures, which proposes expenditures for certain items and purposes.*
- *The words describe items of expenditures (salaries, equipment, travel) or purposes (improving mental health, providing low-income housing...*
- *And the figures (dollar amounts) are attached to each item or purpose (Wildavsky, 1964, p.1).*

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- “Those who make a budget intend that there will be a direct connection between what is written in it” (categories of expenditures) and what is expended (dollars), a connection between “what is written (in the budget) and future events” (p. 1).
- A budget is “intended behavior,” a “prediction” (p. 1).

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- *If the requests for funds are granted, and if they are spent in accordance with instructions, and if the actions involved lead to the desired consequences, then the purposes stated in the document will be achieved (p. 1).*

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- *The budget thus becomes a link between financial resources and human behavior to accomplish policy objectives (p. 1).*
- Wildavsky suggests that the budget is essentially a plan, or actually an experiment or guided set of actions, so that: *through observation (it is) possible to determine the degree to which the predictions postulated in the budget document turn out to be correct (p. 1).*

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Wildavsky states:

- *In the most general definition, budgeting is concerned with the translation of financial resources into human purposes (p. 1).*
- *A budget can be considered a series of goals with a price tag attached.*
 - With this definition, it becomes clear how the budget is a most important tool for any organization in strategic planning.

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- Wildavsky points out that funds are always limited within any organization, and the budget therefore becomes a mechanism to determine which activities are most important, so that those receive the most funding.
- *When the choices are coordinated so as to achieve desired goals, a budget may be called a plan (p. 2).*
- This is a more sophisticated approach to budgeting than is often used, but essential to consider the budget a plan, and for strategic planning.

What is a Budget?

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- If a budget is used as a listing of priorities and goals, the functions of an organization, where money is expended becomes the implementation framework.
- The budget tied to priorities and goals of programs (Program Planning) and also linked to performance of individuals (job description) and outcomes (Performance Planning) the Budget can be viewed as a Work Program.

What is a Budget?

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- A budget can also be considered a Contract, in that is a commitment to expend funds in a specific way to accomplish organizational activities.
- Strict rules define how funds are expended, and controls must be in place to assure proper expenditures, and proper procedures if changes are made.
- These rules are addresses by an Audit.

What is a Budget?

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- The most simple and least valuable type of budgeting is the “line item budget”.
- A “Line Item Budget” looks like words that describe it. There are lines listing funding categories, and dollar figures to the right that identify funds.
- All budgets carry out this “line item” purpose, and this budget format is basic to all budgets.

The Line Item Budget

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- There are general headings or categories used to classify funding expenditures. These broad categories may be broken down into more detail, even down to individual expense items, but all are classified into the following categories, and generally appear in the order listed, especially for any government or non-profit organization.

Categories of the Line Item Budget (and all budgets)

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- **Personnel** – The staff and people who work for the organization. These may be listed by individuals or job titles for small organizations, or totals for larger organization. Personnel costs listed in a budget include:
 - Actual staff salaries for those who work directly within the organization; and
 - Fringe benefits that includes the total of each employees “benefits” to include all expected expenses related to insurance, retirement, vacation and sick leave, FICA and other taxes, and other benefits.

Categories of the Line Item Budget (and all budgets)

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- **Consultants** – Another budget category is provided for individuals hired through contracts to complete specific work, but who do not work directly for the organization. These individuals or activities are generally listed under “contracts.” Organizations may not have staff expertise to complete certain tasks, so consultants are used to complete these needed activities. A consultant fee is based on the anticipated hours worked, benefits, and expenses to the consultant to be paid out of the contract, but the organization pays a total contracted fee that is not generally itemized once a contract is set. The consultant bills the organization for completed activities.

Categories of the Line Item Budget (and all budgets)

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- **Capital Expenses** – Some organizations are responsible for activities that involve major purchases of property, buildings, equipment. These are classified as “capital” expenses in the budget. Capital expenses are generally for any object or expense that will be used for more than 3-5 years, and that cost over \$5,000. It could include cars, construction equipment, buildings owned by the organization, etc.
 - Most government and non-profit budgets are separate capital expenses from Operational Expenses (daily operations), and create a separate budget for capital expenses.

Categories of the Line Item Budget (and all budgets)

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- **Operations Expenses** – The following items are all considered part of the operational expenses for an organization. That includes travel for personnel, office space, equipment and supplies. These categories identify all expenses associated with the operation of the organization, government or business. Desks, computers, phones and phone bills, office space are all part of the operations expenses.

Categories of the Line Item Budget (and all budgets)

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- **Travel** – Many organizations require travel as part of the work expectations. Travel to and from work for employees is not an eligible travel expense, but all required travel from one place to another to carry out work, or travel to conferences or training, are travel expenses that should be reimbursed. Travel expenses for the year estimated in detail to create an accurate budget.

Categories of the Line Item Budget (and all budgets)

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- **Office Space** – All organizations need space to operate, and the expenses for that space are legitimate budget items. This and some other expenses can be itemized and listed at “Direct Costs” in budgets, or as we will see later, are generally included as “Indirect Costs” that are calculated for the organization as a percentage of a total contract.

Categories of the Line Item Budget (and all budgets)

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- **Equipment, Materials and Supplies** – This category includes all equipment and expenses from computers, calculators and photocopy machines, generally those items with more than one year’s use. Materials and supplies include pens, pencils and paper, and whatever miscellaneous expenses are needed for the organization’s operations.

Categories of the Line Item Budget (and all budgets)

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- **Total Direct Costs** – The total of these expenses: payroll (salaries and benefits), consultants, capital costs, travel, equipment and supplies are identified as Direct Costs, the costs that are needed to directly complete the work.

➤ In addition, things like office space and equipment like desks and computers, are often considered as part of the organization's activities (especially for grants), but the organization may also have expenses of accountants, attorneys, personnel and administrative staff, in addition to space and equipment that serve the organization as a whole and not just the grant. These are identified separately as Indirect Costs.

Categories of the Line Item Budget (and all budgets)

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- **Indirect Costs** within organizations are those organizational expenses needed for all activities, but may not be separately identifiable for a specific grant or program.

Categories of the Line Item Budget (and all budgets)

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- **Indirect Cost Rate** – Organizations, especially those that are regularly carry out grants, complete a complicated assessment of these expenses calculated on a regular basis to establish an Indirect Cost Rate, generally a percentage of the total program, but sometimes a percentage of salaries only.

Categories of the Line Item Budget (and all budgets)

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The total budget is generally represented as direct expenses for the program (or grant):

- Salaries
- Consultants
- Capital Expense (in a separate budget)
- Operating Expenses
 - Travel
 - Equipment, Materials and Supplies

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- Plus the Indirect Costs (for office space, desks, etc., as well as staff in personnel, accounting, and administration for the program to work effectively), calculated as a percentage of the total operating budget (previous slide).
- The total operating budget plus the Indirect Costs are added together to form the final or Total Costs expected for an organization, a program, or a grant.

Categories of the Line Item Budget (and all budgets)

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- The Line Item Budget provides a guide and work plan that links activities in the categories with a budget amount for that activity.
- A critical aspect of budgeting is control for those activities, and if funding increases or decreases, then that needs to be reflected in the next year's budget.
- Creating a budget for next year becomes the mechanism to plan and prioritize next year's activities.

Line Item Budgets for Expenses in the Next Year

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- We can identify three stages of the budget cycle. The first is the preparation of the budget, usually for the coming year. With a line item budget this is done by looking at current or estimated expenses, estimating new revenues or funding, or reductions in funding, and projecting those increases or decreases across the budget.

Line Item Budget in Budget Cycles

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- Once a budget is established, it becomes the guide for the current year, and expenditures must follow the budget. This is the "operations" year of the budget.
- Following the operations year, there is a final budget application, the program or organizational audit, where expenditures are checked to make sure they complied with the budget.

Line Item Budget in Budget Cycles

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At any given time there are three budget processes within an organization:

- I. The operation under a current budget (this year)
- II. Planning and the creation of a new budget for the coming year (one year in the future)
- III. The audit of costs and expenses from the previous year to make sure proper accounting and expenditures were made, and to "close the books" on that year's activities.

Line Item Budget in Budget Cycles

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- The line item budget offers the least information in projecting expenses and setting the budget from one year to the next.
- Generally, the expenses for each year are organized by program or department within larger organizations, and increases or decreases are anticipated based on revenue projections.

Line Item Budget in Budget Cycles

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- If growth is expected, each department might be asked to complete a budget that shows no increases for the department and explain how much work will be done.
- A second budget would be created for each department to show 10% increase or decrease, and again to explain increases or decreases in work.

Line Item Budgeting

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- Once these three budgets are made for each program or department within the organization, the directors might meet together to discuss where are the priorities, and submit a budget for all departments to the CEO or the Board of Directors.
- That Board considers the options and combinations with their priorities, and creates a new budget with the changes for the coming year.

Line Item Budgeting

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- This Line Item Budgeting process is subject to politics, both within the meeting with other directors to create a “staff/administrative” proposed budget, and in the final review and determination.
- At both levels individuals may try to influence the decision-making to benefit their programs and priorities.
- Staff in the preparation of budget information can also try to manipulate the process in their favor.

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Strengths

- Demonstrates categories of expenses linked to budget expenses
- Provides a limited linkage of change for future activities in response to existing budget.

Weaknesses

- Based on existing expenses and “status quo” for the future.
- Doesn’t promote larger changes or major assessment of priorities linked to the budget.
- Difficult to address major growth opportunities or losses.

Strengths and Weaknesses of Line Item Budgeting

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- One key component of strategic planning is to create a mission, goals and objectives. This can be done for the organization as a whole, and for each program and department within the organization.
- The assessment of budgets with regard to the goals of each program state clearly the links between the goals and budgets, and offers a strong assessment of priorities.
- This is called Program Budgeting.

Program Budgeting

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- Program Budgeting is simply the inclusions of program goals, not just the name of each program, along with the budget. That way it is clear what will be accomplished with funds to that project, and changes can be made to reflect the priorities of those goals.
- Program Budgeting creates a stronger link to the organization's mission and goals by tying those directly to budgeting.
- Changes in goals produce changes in the budget for next year.

Program Budgeting

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- Within the Strategic Plan for an organization, each program should be identified, and in addition to its overall Mission, Goals, Objectives, Tasks, and Work Program, there should be a separate Mission, Goals, Objectives, Tasks, and Work Program for each Department or Program within the Organization.
- These Program Goals and the Work Program including Outcomes can be used to identify and prioritize programs within the organization's budget.

Project Budgeting and MBOR

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- A good strategic plan not only identifies Goals and Objectives, but also identifies performance outcomes of the organization.
- Performance also includes the work of each individual within the program or department. Performance assessments can be used to establish a written Performance Statement for each job within the organization. Individual Performance can then also be assessed on a regular basis.
- Both performance of the department and performance of individuals can be linked to the budget process.

Performance Budgeting

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- One of the best processes to incorporate Strategic Planning within the organization is to identify both program goals and performance outcomes throughout the organization, and tie budgeting to priorities of the organization and performance of programs and staffs.

Program Performance Budgeting (PBG)

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- PPBS (Program Performance Budgeting Systems) include Program Goals, listing of Personnel, and Outcomes along with the detailed budget for that program or department.
- Priorities within the program and across the organization can be linked to Performance and priorities.

Program Performance Budgeting (PBG)

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- Zero Based Budgeting (ZBB) was introduced in the federal government in the 1960's, with the purpose to be able to make and respond to change within the organization.
- ZBB functions in some ways as a line item budget, but instead of starting with the funding level of least year, each program and department starts with zero.

Zero Based Budgeting (ZBB)

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- In ZBB each program and department has to justify and explain all expenditures and costs in their budget, and identify different levels of funding and what their performance would be at those levels, including zero funding.
- ZBB is effective in linking programs and performance to budgeting, but it is time consuming to carry out each year.

Zero Based Budgeting (ZBB)

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- Modified ZBB uses the same principle as ZBB, but instead of starting at Zero budget, it requires programs and departments to discuss their goals and performance objectives in terms of increases in funding and decreases of funding, explaining what they could or couldn't do in terms of performance and meeting their goals at each level.

Zero Based Budgeting (ZBB)

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- In summary, we have seen that budgeting is much more complex than just tracking or setting spending.
- The most effective systems of budgeting, PPBS, are an excellent way to merge the products of strategic planning with MBOR into a control document for the organization and each program or department.

Budgeting: One Step to Implement Strategic Planning

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- A major assessment within Strategic Planning should be analysis of the Budget and Budget Processes within the Organization.
- The Budget as a document or plan should include the details of the goals or each program, staffing levels, and performance outcomes as part of the budgeting information.
- The Budget and the Budget Process becomes a critical document and component of any Strategic Plan.

Budgeting: One Step to Implement Strategic Planning

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