Legislative Review of State Programs

A Report to the Governor and the Legislature of the State of Hawaii

Conducted by

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Submitted by

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Foreword

In 1968, the Hawaii State Legislature sponsored a four-day seminar on budgeting for all state legislators and the heads of various state departments. A faculty of five distinguished national experts on planning and budgeting conducted the seminar. That seminar stimulated legislative interest in reforming the review and budgeting of state programs and led eventually to the passage of the Executive Budget Act of 1970. The 1970 act continues to govern state budgeting today.

The thrust of HCR No. 202, 1990, is to recommend methods to strengthen the Legislature's capacity to review state programs. Because budgeting is the single most important process involving and affecting legislative review of programs, we believed that the study called for by HCR No. 202 would be enhanced if it could be conducted by those with the national experience and perspective of the 1968 faculty.

We learned that two members from the 1968 faculty were indeed available to conduct the study: Dr. Allen Schick and Dr. John Haldi. Dr. Schick is one of the foremost authorities on budgeting in the United States and is currently Professor of Public Policy and Director of the Bureau of Governmental Research at the University of Maryland. Dr. Haldi is an economic and management consultant and was formerly chief of the program evaluation staff of the then U.S. Bureau of the Budget.

We join the authors of the report in expressing appreciation for the assistance of legislators and former legislators, legislative staff, executive agency personnel, the Tax Foundation of Hawaii, and others who provided interesting and valuable information for the study.

Newton Sue
Acting Auditor
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Chapter 1

Introduction

Thirty years after statehood, many leaders and members of the Hawaii Legislature sense that their institution needs to be strengthened to address major issues facing the State.

House Concurrent Resolution No. 202 of 1990 notes the proliferation of policies and programs mandated by the Legislature, the inability of the State to attain many of its program objectives with available resources, and the lack of an analytic framework for assessing old programs and proposed new ones. To remedy these perceived shortcomings, the resolution requests the auditor to recommend ''methods to strengthen the Legislature's capacity to determine the appropriateness and productivity of State programs.''

The study conducted pursuant to this resolution focused on the two principal roles of the Hawaii Legislature:

1. the power to legislate policy for the State; and

2. the power to appropriate funds for public programs and agencies.

The Legislature's role, which is spelled out in the Hawaii State Constitution, is deeply rooted in the American system of government. Across the country, the past two decades have seen many state legislatures take significant initiatives to improve their operations and play a more active and responsible role in shaping government policy. The request for this study is in keeping with such initiatives.

Informed Policy Making

Informed legislation is a fundamental prerequisite of responsible government. This report is animated by the conviction that the Hawaii Legislature should be an informed and independent voice in determining state policy.

To be ''informed'' means that the Legislature must have timely and relevant information before it acts. It needs to be able to question executive proposals, to assess and initiate alternatives, and to take account of the likely ramifications of its actions.

To be ''independent'' means that the Legislature can stake out its position on matters requiring legislative action and that it have the capacity to devise legislation that differs from proposals submitted by the executive. An informed and independent Legislature will often follow the executive's lead, but it will do so because it is confident that the proposal is sound, not because it cannot act on its own.

Informed Budgeting

Many substantive policies require money in order to be implemented. The budget, therefore, is the means of financing policy objectives established by the government. This is the logic of the planning-programming-budgeting (PPB) system established by law in 1970.[1] PPB was designed to be an integrated system for translating policy objectives into governmental programs and making biennial appropriations for approved programs.

Informed budgeting requires that the Legislature have available analyses and data that show where money is being spent and what is being accomplished by state programs. It is essential to informed budgeting that the Legislature have an independent capacity to utilize the information supplied, to inquire into the conduct of existing programs, and to consider thoroughly the possible impacts of proposed new programs.

General Themes

Among the current and former legislators interviewed for this study, some expressed the feeling that the Legislature could do a better job of performing its policymaking and budgetary responsibilities. Some legislators expressed dissatisfaction with the manner in which major initiatives are considered; others expressed dissatisfaction with the PPB budget process.

There was a general feeling that the Legislature is overwhelmed with data, yet not fully informed about the issues at hand. A characteristic response was one of frustration--better information and more resources are needed to do a better job.

Despite dissatisfaction, little support was found in legislative ranks for tearing down the established processes and replacing them with entirely new ones. What is sought are improvements to make the existing policy and budget processes work better, so that those who legislate can feel they do so in a more informed and responsible manner. This sentiment seems especially prevalent with respect to the Legislature's budgetary role. Complaints about the PPB system coexist with the notion that the system should be improved, not dismantled. These attitudes found support in our review of the material available to the Legislature when it makes budgetary and policy decisions. The volume of information supplied is quite impressive, but it often is not sufficiently relevant to legislative needs and actions that have to be taken.

This report contains five general themes that pertain to the capacity of the Legislature to make informed policy and budget decisions. More specific findings, along with recommendations, are presented in subsequent chapters.

1. **Information provided to the Legislature needs to be improved.** This theme pervades the entire report. In many instances, the volume of information is plentiful, but usually it is framed in terms of the perspectives and interests of executive agencies and is not targeted to legislative needs. When program initiatives are proposed to the Legislature, however, the informational shortfall can be troublesome.

2. **The Legislature's staff resources and capacity need to be enhanced.** Legislative capacity has not grown apace with the expansion of Hawaii government. The lack of adequate staff, during both the session and the interim, was well documented in the 1989 report of the National Conference of State Legislatures on strengthening Hawaii's legislative capacity.[2] Adequate staffing is essential to responsible government. Without proper staff, complex and voluminous data tend to hinder--not facilitate--legislative performance. Staffing inadequacies spur shortcuts to get through the session's workload, foster dependence on the executive branch, and weaken the Legislature's inclination to exercise independent judgment. Chapter 2 elaborates on the need for enhanced staff capacity.

3. **The Legislature needs to strengthen its capability to generate independent requests for information and analyses.** It needs a regularized means of demanding targeted responses to its questions and concerns. An increased informational flow in response to specific requests would improve the submissions provided by agencies. This would widen the options available to the Legislature, and enable it to exercise more independent judgment. The design of a policy and budget process based on demand is spelled out in Chapter 2.

4. **Budgetary information should be shaped to help the Legislature focus on incremental decisions.** The focus on increments is embedded in both executive and legislative behavior, and it would be of little avail to insist that the budget be remade from ground zero each biennium. The incremental process needs to be rationalized, however, by establishing a linkage between decisions about incremental funding and incremental performance. An emphasis on incremental change

would enable the Legislature to make more effective use of the performance measures presented in the budget and might pave the way for viewing the budget as a "contract for performance," along the lines discussed in Chapter 3.

5. **The PPB system should be streamlined in ways designed to facilitate legislative review.** The PPB system is the single most important source of information on objectives, costs and performance. Yet none of the legislators interviewed for this study see it as fully relevant to their needs. Specific recommendations for simplifying the PPB system are presented in Chapter 4.

Opportune Conditions for Strengthening Legislative Capability

This report takes the position that political cohesion and the Hawaii Legislature's tradition of being open to new ideas, changes, and improvements present opportune conditions for strengthening the Legislature's independent role in policymaking and budget review.

In today's political environment, improvements can be introduced in a spirit of cooperation between the executive and legislative branches, with the shared objective of enabling the State to allocate its resources in the most effective manner.

Chapter 2
Informing the Legislature

Hawaii legislators must often make far-reaching decisions without adequate information. As the scale and scope of Hawaii government have expanded, the gap between available and needed information has widened.

Information Requirements

By one important measure--the range of functions assigned to state government--the Hawaii Legislature needs more support than that of virtually any other state. In addition to the typical state functions, such as higher education and highways, the Hawaii government operates public schools, airports, harbors, acute and long-term care hospitals, libraries and social services. Accordingly, the informational needs of the Hawaii Legislature are more varied and complex than elsewhere. Not only does the Legislature have to make "big picture" policies, it also must be involved in operational issues directly affecting the well-being of communities and households.

The volume of information supplied to the Legislature is often massive. In some cases, the amount supplied may seem like a tidal wave. It usually is framed in terms of the perspectives and interests of executive agencies, however, rather than being targeted to legislative concerns.

The Legislature often cannot make effective use of much of the data and information that it receives. Sessions are brief; staffs are small and inexperienced. These factors make it difficult to process and interpret all the available information, to question its completeness or relevance, or to explore alternative approaches.

The informational shortfall is especially troublesome when program initiatives are proposed to the Legislature. For one thing, major initiatives are sometimes unveiled after the session has begun, and many weeks after the budget has been presented. Subsequently, they are enacted without sufficient consideration of their relationship to existing activities, what they are intended to accomplish, or their impact on future budgets. New initiatives also escape probing budgetary review. The appropriations process concentrates on providing increments to ongoing programs, and there is often not enough time or the right information to do a thorough job of assessing new undertakings.

Reliance on Information from the Executive Branch

The Legislature gets the policy advice and information that others want to give it. This situation arises out of the current emphasis on executive initiative in supplying information and advice to the Legislature.

The prevailing view has been that if agencies supply an abundance of information, the Legislature will be better able to perform the tasks assigned to it. The reliance on information supplied by executive agencies reflected overwhelming confidence that if data were made available, they would be used.[1] This posture may derive from the basis of the planning-programming-budgeting system, which is organized around the submission of prescribed data in the various budget documents. The Legislature's almost total reliance on executive submissions entails two major shortcomings:

1. An overabundance of data, especially when not in a highly usable format, can confine the Legislature to a relatively limited and passive role.

2. Over time, the information supplied has been shaped more to support executive proposals and budget requests than to enable the Legislature to come to its own decisions.

The emphasis on supply enables those who control the flow of information and advice to dominate the legislative process and narrow the options available to the Legislature. This is probably one reason why some legislators feel frustrated by the PPB process. They receive great quantities of budgetary information that support the executive budget request, but not enough to let them exercise much independent judgment.

Recommendations to improve the quality and relevance of information that is supplied to the Legislature are contained in Chapters 3 and 4. The balance of this chapter focuses on the Legislature's capacity to demand and utilize information.

Legislature's Capacity to Demand Information

The 1989 report by the National Conference of State Legislatures (NCSL), referred to previously, provided convincing evidence that the Hawaii Legislature is understaffed compared to legislatures in many other states. The reach and responsibilities of the government are now far greater than at the time of statehood. This trend is not unique to Hawaii, but other states have made more progress in gearing up their legislatures for expanded responsibilities.

Adequate staffing is not a luxury; it is an essential to responsible government. Without proper staff, complex and voluminous data hinder legislative performance and unbalance the relationship with the executive branch.

Legislative committees are inadequately staffed

The House Finance Committee and the Senate Ways and Means Committee must become sufficiently familiar with the budget to make hundreds of appropriation recommendations to the House and Senate. The NCSL study reported that because these committees have only small core staffs, they are forced to rely largely on temporary, relatively inexperienced persons detailed or hired for three to four months of concentrated budget work. Few of those assigned this demanding task return in ensuing sessions. Almost every year the core staff of the money committees must once again train raw recruits.

One consequence of the high staff turnover is a sharp reduction in "institutional memory." At the beginning of each budget cycle, the staff has few members who can remember what agencies submitted, or failed to submit, during the previous budget review cycle.

The situation is hardly better with the subject matter committees that have jurisdiction over legislative proposals. These committees have meager staffs of their own to undertake in-depth review during or after the session, and less access than the money committees to temporary staff obtained from the legislative staff agencies or executive departments.

Consider the situation which arises every two years when the biennial budget is submitted to the Legislature. Documents adding up to thousands of pages are delivered to member and committee offices. Packed into these pages are many tens of thousands of data entries--spending estimates, cost projections, comparisons of expected and actual performance, measures of effectiveness, data on personnel, and numerous other items. The documents are dense and the data complex because Hawaii state government is a big business that takes in and spends more than $2 billion (general fund) every year. In view of the shortness of the session, the lack of staff assistance, and other responsibilities, is it any wonder that some legislators report that they put the hefty documents on the shelf and do not use them?

The Legislature needs capable people who have the time and experience to sift through these voluminous documents, find those critical points that need to be probed, and prepare short, pointed synopses for busy legislators. Although budget review is not an "adversary process" in the usual sense of that term, executive agencies should not be expected to flag for attention flaws and shortcomings in their operation. Executive agencies understandably endeavor to put the "best face" on their legislative proposals, whether those be substantive issues or budget submissions.[2]

The flow of information that now engulfs the Legislature is virtually certain to continue. Our society is in what is commonly described as an "information age." The number and size of computerized data banks grow each year. Computers now have the ability to spew out massive amounts of data and information, far faster than people can absorb it. What decision makers, especially legislators, need is a new type of information specialist, one who knows how to sort through the inundation and boil the critical essentials down into a crisp one or two page presentation.

The lack of adequate staff spurs legislators to favor shortcuts that get them through the session's workload. It fosters dependence on the executive branch and weakens the Legislature's inclination to exercise independent judgment. The Legislature would be well advised to continue implementing the staffing recommendations contained in the 1989 report by the National Conference of State Legislatures.

Need for an Information Process Oriented to the Legislature

Gearing the information process to the Legislature

As the title of this chapter suggests, the information flow from executive agencies is viewed in terms of the Legislature's needs and perspectives. Shifting the perspective from what is supplied by executive agencies to what is demanded by the Legislature is far more than a superficial change in labels. It is the difference between having an informed Legislature and one whose capacity for action depends on what others are willing to give it.

An informational process designed to serve legislative concerns and interests exists when studies and data are generated in response to specific questions or requests that arise from legislative concerns and interests.[3] The commissioning of special studies by the Legislature provides a good example of demand-generated information. In recent years, the Legislature has commissioned its own service agencies (the Legislative Reference Bureau and the Office of the Auditor) to conduct a number of studies on such specialized topics as tax credits for the elderly, financing higher education, maximizing federal Medicaid funds, and care of the developmentally disabled.

It is true that during each session the Legislature generates numerous ad hoc requests for information from executive agencies and the Judiciary. These are generally handled with dispatch by the affected agencies. The arrangement tends to be hit or miss, however. In view of the time pressures during the session, many legitimate concerns of the Legislature may not be addressed at all, while other concerns fail to receive adequate attention.

For information requests that are directed to agencies during the session, the legislative timetable requires that responses be submitted within a relatively short time span. Agencies do not have time to undertake studies or extensive data gathering. Only that information which is readily available can be supplied in time for legislative deliberations. This reality tends to restrict the types of questions and requests that can be asked *during each session.* Although some information is produced in response to legislative demands, the present process is nevertheless largely dominated by the executive.

Imbalance between the information supply and legislative needs

An imbalance currently exists between information supplied by the executive and demands of the Legislature. A chronic drop in the Legislature's demand for information occurs between sessions. Once the session is over, the information flow from the Legislature, in the form of questions and requests, declines. In consequence, agencies receive comparatively little feedback on their voluminous submissions.

A process that is tailored to serve agency interests while ignoring legislative initiative or feedback is likely to become a rote exercise, with agencies providing mechanistic updates of the same information year after year. The PPB system, launched with so much promise two decades ago, has succumbed to this tendency. The same narrative descriptions and program measures are published in each budget, with only minor updates and cosmetic changes. A process oriented more to legislative needs would increase the capacity for fresh data and insights, as it would be driven by each session's legislative agenda and interests.

Another shortcoming of a supply-dominated process is that it tends to operate in a closed environment, with little, if any, public input or access. A process that reflected greater legislative demand could operate in a more open atmosphere, in which the interested public might have a role in framing the issues submitted to agencies or in assessing their responses.

Recommended procedure to strengthen legislative demand

In order to generate more information based on specific legislative requests, it is recommended that legislative committees implement the *interim inquiries process* described here. This process would give legislators an opportunity to formulate and ask important questions that might otherwise be forgotten or overlooked during the session.[4] Such a process would also help the Legislature to specify its informational needs and pinpoint the types of data to be provided by agencies. It would be an important supplement to the existing supply-based system.

The pace of business during the session is extremely brisk. It does not permit adequate attention to be given to many important issues that confront the Legislature. With more adequate staff resources plus a minimal organizing and oversight effort by legislators, the amount of valuable preparatory work accomplished during the interim could be greatly expanded.

The interim inquiries process envisioned here would require that between sessions the legislative committees systematically generate a written list of questions and information requests for executive agencies. The process is simple and straightforward. Agencies need to be given adequate time in which to develop their response, however. Inquiries from the committees should therefore endeavor to work around the agency "budget crunch" in the late summer and fall.

Some time in the latter part of May, the committee staffs (or the legislative analyst, if that office is activated) should assemble and distribute to committee members a preliminary list of proposed questions and information requests for each agency. Committee staffs would be expected to prepare and submit questions on their own initiative, and committee members would be invited to suggest questions. The initial list should be circulated and returned, with comments and any additional questions that come to mind, within two or three weeks after distribution, some time around the middle of June. The committee staffs would incorporate all responses into a revised list, and the committees would then review the questions and submit them to the appropriate agencies.

The committees would submit the questions and information requests sometime around the middle of July. Questions might deal with issues considered likely to arise during the next session. Alternatively or in addition, they could usefully pertain to items in the most recent budget submission, such as outputs, measures of effectiveness, cost-effectiveness and productivity enhancements (or lack thereof), and so forth. Agencies would be expected to respond to these questions as part of, or in conjunction with, their next budget submission.[5]

To be fully effective, a demand-based process such as that envisioned here would depend on the Legislature's having sufficient staff resources to help define issues and make specific requests for information. The process could begin on a trial basis.

Conclusion

The Legislature needs to improve its capacity for dealing with the voluminous amount of information it now receives as a result of the supply-dominated process. At the same time, it may be possible to improve the quality of some of the information that is regularly supplied to the Legislature. Better quality will not occur through a one-time mandate, however. Rather, the Legislature needs to correct the current imbalance between legislative needs and the supply of information.

The focus should be on improving both legislative capacity and procedures for defining the information that the Legislature needs. This demand-generated process should be continuous and ongoing. When this occurs, the information supplied will be more responsive to legislative needs and concerns.

Chapter 3

Budgetary Responsibilities of the Legislature

The Hawaii Legislature is awash in budgetary data. At the start of each biennial appropriations cycle, the Legislature receives about 3,000 pages of densely-packed budget documents. The documents include (1) the multiyear program and financial plan, (2) program memoranda, and (3) the variance report. All told, they contain over one million data entries. The Legislature nevertheless feels impelled to ask for thousands of additional pages of supplementary documentation. These differ, not only in detail, but also in focus. In addition, during formulation of the appropriations bills, the money committees make numerous requests for information on matters before them.

The paradox of budgetary inadequacy amidst a torrent of budgetary data is the subject of this chapter. In examining causes of this paradox, one is struck not only by the volume of data, but also by the variety. A marked difference exists between the data contained in official budget documents and those found in the supplementary submissions. The official documents display the budget; the supplementary data provide the basis for making decisions.

This chapter first describes differences between the regular and supplementary budget submissions. It then recommends changes to enhance legislative responsibility. The next chapter concentrates on the PPB documents that comprise the regular budget submission and recommends ways of making them more relevant to legislative needs.

PPB Budget Process

As required by the Executive Budget Act, the governor initiates each biennial appropriations cycle by submitting a set of PPB budget documents to the Legislature in December of each even-numbered year. Supplemental budget documents are also submitted in December of each odd-numbered year to request amendments to the appropriations made for the biennium. As noted previously, the main PPB documents are as follows.

1. **Multiyear program and financial plan** contains program and financial information on the current biennium, the executive budget for the next biennium, and projections for the following two biennia.

2. **Program memoranda** describe the program and discuss key issues in each of the budget's 11 programs. Program memoranda share the PPB program structure and are formatted in ways that ease the task of relating past results and current budgets.

3. **The variance report** compares actual and budgeted financial and program results for the last complete fiscal year and the first three months of the current year.

The expectation of the 1970 law was that this integrated set of budget documents would tell the Legislature all, or almost all, it needs to know in order to make informed financial and program decisions. The PPB framework made it possible, it was reasoned, to make appropriations for the next biennium in the light of what was accomplished in the period just ended and with an eye to the impact on future budgets.

The focus of the PPB law enacted in 1970 was on preparation of the budget in the executive branch. From the vantage point of the 1990s, one can discern that inadequate attention was given to how the Legislature would actually come to grips with the budget, or to the resources it would need to cope with the volume of material generated by the PPB system.

Supplementary Budget Materials

In lieu of the official budget materials, legislators tend to focus almost exclusively on supplementary material, which is where legislative budgeting actually occurs. Five sets of data supplement the PPB documents. They are generated in the course of executive preparation and legislative review of the budget. The five supplementary sources are:

1. Incremental requests
2. Budget justifications
3. Departmental budgets
4. Prepared testimony
5. Legislative budget worksheets

Incremental requests

Throughout formulation of the governor's budget, a distinction is made between *base* and *incremental* expenditures.

The *base* consists of the current approved program as adjusted for expected inflation and other built-in spending changes. During preparation of the budget, the Department of Budget and Finance notifies each agency of its current funding level for the next biennium.

Increments above the base level may be requested by each agency. These come in the form of either workload adjustments or program change requests. The latter are the interface between the incremental process and the formal PPB system. Each program change request is accompanied by narrative and statistical information on projected program and performance levels.

The items which are of prime interest in the executive budget are the workload adjustments and program change requests. These are also the focus of the governor's budget decisions, especially during good years when the economy is growing and increments are plentiful.

The division of the budget into (1) the current approved program and (2) the proposed increments pervades both departmental and legislative budgeting. At all stages of the process, the attention of participants is on the budget increments. Yet, despite the prominence given to the increments by budget makers, neither the executive budget nor the program and financial plan draws this distinction.

Budget justifications

When preparing requests for the next biennium, departments fill out detailed budget justification tables which list all personnel and other operating expenditures. These tables--called "BJs" by budget insiders--are extraordinarily detailed. One table lists every position by pay level and other job-related information. Another BJ table sets forth individual items of expenditure, such as janitorial supplies, laundry supplies, and so on.

Printouts of the BJs are provided to the House Finance and the Senate Ways and Means Committees, but not to subject matter committees. Hardly any of this expenditure detail appears in the published budget. The budget consolidates the detailed line items into four broad categories for each program account:

1. Total personnel costs
2. Other operating expenses
3. Equipment
4. Motor vehicles

The extent to which the BJs are actually used varies with the inclinations of those making the decisions and the financial condition of the government. These bits of data are used to pinpoint the items for which additional funds have been requested. They underlie and have thereby become part of the incremental process.

Departmental budgets

Departmental budgets are assembled in the case of the Department of Education and the University of Hawaii. They are used both for internal management and for informing relevant legislative committees on program and financial matters. These documents do not have a standard format, but they generally focus on incremental expenditures. For example, the Department of Education classifies its budget into current services, workload increases, and program adjustments.

Department heads, administrators and managers need detailed information at their disposal. Accordingly, departmental budgets typically provide considerably more program detail than is published in the executive budget. Thus, the Department of Education breaks down its budget into one level below the lowest program level at which appropriations are made.

Prepared testimony

Each department submits testimony on its budget to the Finance and Ways and Means Committees. This testimony follows a standard format that covers:

1. Program objectives and activities
2. Issues or problems
3. Program changes recommended to remedy the problems
4. Expenditure data (including the amounts transferred into or out of each account or restricted by the governor)
5. Brief justification of the budget request

The statements are typically brief, usually only six to ten pages. However, a separate statement is prepared for each appropriation account. Since there are approximately 300 programs for which appropriations are made, this testimony adds up to more than 2,000 typed pages of budget information.

More important, the prescribed format for the prepared testimony offers a powerful clue into the matters that most concern the money committees when they put together the appropriations bill. Judging from the material in the prepared testimony, these committees want to be alerted to problems requiring legislative attention, they want to know whether funds provided for the current biennium have been shifted to other uses or withheld, and they want departments to justify the increments requested for the next biennium.

Legislative budget worksheets

In recommending appropriations, the Finance and Ways and Means Committees use budget worksheets to record all proposed adjustments to the current funding level. The budget worksheets separately list three types of adjustments:

1. Executive budget proposals, including workload changes and program change requests

2. Proposals advanced by the governor after the budget was submitted

3. Spending changes initiated by any of the money or subject matter committees

Most adjustments pertain to proposed spending increases, but proposed reductions are also listed. The various adjustments are arrayed sequentially for each account. The worksheets are computer-generated documents that are updated as committee work on the budget progresses. The final set of worksheets shows the amount of each proposed adjustment and the amounts appropriated for each year of the biennium. The worksheets used for the 1989-91 biennium listed more than 1,700 proposed adjustments and totalled almost 500 pages.

Parallel Budget Process

The five sources of supplementary information described above constitute the operative budget process. They are connected to the regular budget submission in one significant way. Like the PPB documents, the supplementary sources of budget information are organized according to the State's program structure. The program structure is the key to locating budgetary information in both the regular and the supplementary budget documents. Each lowest level program in the executive budget is a separate appropriation account.

Different focus of PPB and supplementary budget submissions

Although the regular PPB and supplementary budget submissions are linked via the program structure, the focus of each is quite different. Whereas the PPB system emphasizes program outputs, the supplementary information focuses on spending inputs, such as the amount requested for additional supplies. Moreover, while the PPB documents concentrate on the total program--what it is expected to accomplish and cost--the supplementary documents focus on the increments.

The supplementary documents tell us what executive officials and legislators look for when they decide the budget. They care about where the added spending is going and the things it will buy. These types of concerns predated the PPB system. Indeed, a key objective of PPB was to reorient Hawaii budgeting from line item inputs to program outputs, and from incremental expenditures to program costs.

Instead of driving inputs and increments out of budgeting, however, PPB merely forced the information to be revealed through other processes and documents. Although the regular budget submission conforms to the PPB model, it might fairly be described as only the tip of the budgetary iceberg. Underlying the regular budget submission is the extensive amount of supplementary information. This supplementary information constitutes the bulk of the operative budget process.

Alternatives

In seeking to remedy the defects in having two parallel systems, the Legislature has three broad options:

1. Discard the line-item incremental system

2. Jettison the PPB system

3. Merge the two systems

The first option would dismantle the system actually used in budgeting, while the second would deprive the Legislature and executive officials of the benefits of PPB.

Two decades after PPB was launched, it would be futile to urge jettisoning of the supplementary information system and a full return to an exclusive PPB system. Executive officials and legislators have come to rely heavily on the supplementary information precisely because PPB does not adequately meet their needs for budgetary information. The first option does not represent a satisfactory solution.

At the same time, it would be short sighted to roll back the clock to the pre-PPB days and abandon a system that tries to assess the program implications of financial decisions. PPB was introduced precisely because the line item, incremental approach underinformed legislators about program and financial implications of their budget decisions. The second option would be a step backwards. Adoption of the third option is therefore recommended.

Recommendations

Combine the two budget systems into one

The coexistence of (1) a regular budget submission that is used for little more than display, with (2) an extensive supplementary submission by means of which resources are allocated, is both cumbersome and costly. Maintaining separate systems adds significantly to the financial and administrative costs of budgeting. Many thousands of hours are devoted to assembling reams of budgetary data that are published but not used. At the same time, some legislators complain that they lack sufficient data to make informed budget decisions. The PPB system does not give them the information they want, and the alternative data are not readily accessible to them.

RECOMMENDATION NO. 1: The PPB system and the incremental system should be integrated.

The two systems can be merged by transforming the incremental system into one that links increments in financial resources with increments in performance. A merged system offers two major benefits.

1. It will help focus on a perennial question facing executive and legislative budget makers: What additional or improved services will result from the additional expenditures?

2. It will make incremental budgeting more rational by ensuring that decisions on spending increases are made with knowledge of the impacts on performance levels.

A protective attitude toward the current funding level exists, regardless of whether the budget process is structured to focus on spending increments. There is reason to expect, however, that the bias in favor of the current funding level might be mitigated by integrating the PPB system with the incremental process.

One approach would be to maintain the current funding level but to use the merged approach to reallocate resources within it. An inherent strength of the PPB system is its focus on outputs and performance, rather than line item inputs. Properly applied, this focus can be the most useful and rational way to upgrade programs and increase productivity. Spending changes can be made "at the margin," where the amount of output and performance to be gained or lost can be analyzed. The Department of Budget and Finance should be encouraged to format the budget request so that agencies are asked to show where reductions might be made to accommodate program change requests.

A merged system would rely on existing sources of data. Consequently, it would not add to the burdens of preparing and reviewing the budget. In fact, recommendations made in this and the next chapter would simplify the task of preparing the required material. A merged system would be more informative, while requiring fewer data entries than the existing arrangement. The remainder of this chapter sets forth the steps recommended to integrate the two systems.

Focus the budget process on increments to the current funding level

There is overwhelming evidence that all participants in the Hawaii budget process concentrate on proposed adjustments to the current funding level. This incremental posture is so embedded in budgetary practice that it will not be uprooted by divesting the published budget of all telltale signs of incremental behavior. What is recommended instead is that incremental issues be prominently displayed in the executive budget submitted to the Legislature.

RECOMMENDATION NO. 2: The executive and legislative budget processes should focus on adjustments to the current funding level. The executive budget should provide information on the current funding level, proposed workload adjustments and program changes, and justifications for these adjustments.

This recommendation can be accomplished by showing, within each program account, (1) the current funding level (or current approved program), (2) workload adjustments, and (3) program change proposals.

Emphasize programmatic impacts of incremental budget changes

The proposed adjustments would be presented in a manner that emphasizes their programmatic impacts rather than the additional line items to be purchased.[1] The format used by the Department of Education in its internal budget might serve as a model for a budget document structured along these lines.

RECOMMENDATION NO. 3: For existing programs, proposed workload or program adjustments should be accompanied by estimates of the changes in performance levels that would result from the increased expenditures.

Every proposed adjustment to the current funding level should entail a change in one or more measures of performance.

- **Workload increases.** When a request is made for additional funding due to a rising workload, the budget should project corresponding increases in program activity levels.

- **Program change requests.** Whenever additional resources are requested for program changes, the proposal should be justified in terms of improvements in performance, such as in the measures of effectiveness associated with the particular program.

Spending increases proposed for the biennium immediately ahead are likely to be in the form of workload adjustments or program change requests. For these, the incremental procedures outlined in this recommendation would provide sufficient information on estimated costs and results.

The link between the spending and output sides of the budget should be direct and explicit. Every proposed funding adjustment should be accompanied by projected changes in outputs, productivity, and cost-effectiveness.

Require more information for new program initiatives

Over the long haul, the State budget is driven upward by major program initiatives that typically have low startup costs, but which generate substantial expenditures when fully implemented. By the time these additional expenditures are recognized, they are already built into the budget and are difficult to dislodge, regardless of any merits or lack thereof.

RECOMMENDATION NO. 4: For new programs, the executive budget should provide detailed projections of future budgetary impacts, the objectives sought, and the measures by which achievement of these objectives will be monitored. The feasibility of a pilot test should be explicitly considered for each major program initiative.

The best time to make informed decisions about new program initiatives is when they are launched. Typically, expensive initiatives are proposed in the governor's State of the State address. This major speech is delivered several weeks after the executive budget is submitted. The almost inevitable result is that the Legislature lacks timely and reliable information on future budgetary impacts.

It is widely accepted that a state's financial soundness can be impaired through bypassing the budgetary process when initiating major program expansions. The process suitable for routine incremental requests may not suffice for costly initiatives, whose full financial impact will not be recorded in the budget for another two or more biennia. For these proposed expansions, a special and more searching process is required to ensure full consideration of the options at hand and the program and financial consequences of each.

Ideally, major initiatives launched by the governor would be accompanied by analyses that set forth options, examine alternatives, project costs and results of full implementation, and explain the selection of the recommended course of action. In addition to assessing the desirability of a pilot test, the analyses should include a ''risk analysis'' that assesses the likelihood that things may not go as planned. When the new Office of the Legislative Analyst authorized by Act 347, SLH 1990, is activated, it could play a productive role in examining major program proposals for the Legislature.

Pilot test contracts for performance

A merger should bring together the input and output sides of the budget. Once this is accomplished, it should be feasible to conceive of the budget as a ''contract for performance'' in which spending agencies would agree to provide a specified level of service in exchange for receiving a fixed amount of money. This conception of budgeting has been embraced by a number of countries such as Australia, Canada, England, and Sweden. The State of Colorado has also applied a limited version of a budget contract to selected agencies.

RECOMMENDATION NO. 5: The Department of Budget and Finance should, in cooperation with the House Finance and the Senate Ways and Means Committees, pilot test memoranda of understanding with executive agencies setting forth the expected expenditures and performance for the next biennium or longer. Each memorandum would establish a contractual relationship between the government and the affected agency covering both the resources to be provided and the services to be performed. The memoranda should be submitted to relevant legislative committees to ensure adherence to substantive laws and appropriations.

The budget contract would be effectuated through a memorandum of understanding negotiated by the spending department and the Department of Budget and Finance.[2] The memorandum would be negotiated immediately after appropriations are enacted for the next fiscal biennium and would reflect the policies and spending levels approved by the Legislature. The memorandum has two core elements: (1) the financial resources that will be made available to the agency for two years ahead; and (2) the specific services that the agency will provide. The services are usually expressed in quantitative terms, such as the activity or program level, or measured improvements in performance.

This process promises a number of benefits to both sides in the agreement. It gives spending agencies an assured supply of funds, and it gives the government a commitment from the agency to carry out an agreed level of activity. In effect, the budget control agency agrees not to restrict or impound funds during the period covered by the memorandum of understanding (unless the level of spending set forth assumes that funds will be withheld), and the expending agency agrees not to seek supplemental funds during the biennium. Of course, unforeseen changes in financial conditions, such as an unanticipated budget deficit or significant overruns in mandatory expenditures, can compel the executive to restrict funds or the affected agency to request additional resources.

The memorandum of understanding establishes a direct link between resources and program results. Although there is no breach of contract remedy if an agency fails to produce at the negotiated level, the agreement focuses the agency's attention on projected accomplishments during the contract period. The memorandum of understanding thus becomes a powerful tool in organizing the agency's work and in channeling resources to intended activities.

It should be stressed that the agreement emerges from give and take negotiations. The measures of performance agreed to in the memorandum are not imposed by outside authority but are voluntarily agreed to by the affected agency as appropriate and achievable measures of what it expects to accomplish. They are the means by which the agency consents to have its performance assessed.

For an agency to commit itself to a level of performance, it must have some discretion in spending available resources. Accordingly, governments which have introduced the memorandum process generally grant the spending agency increased budgetary flexibility. Some of the external controls maintained by the budget office (or other organizations, such as the personnel office) are relaxed and the agency is permitted to shift funds among the line items without receiving advance approval. For example, the agency may be allowed to shift operating funds between personnel and other line items.

One advantage in pilot testing this process is that it will likely focus attention on problems in providing agencies with sufficient managerial flexibility to operate efficiently and fulfill their "contractual" obligations. Some of the problems might derive from the budget and allotment process, others from personnel or procurement controls. A fully operational memorandum of understanding process might require that the Department of Personnel Services or the Department of Accounting and General Services participate in the negotiations. In urging that this process be pilot tested, this report holds that the give and take between operating departments and the central staff agencies will be a valuable side benefit.

Another form of flexibility which has been pilot tested in some jurisdictions is to give agencies limited discretion to transfer funds between the fiscal years covered by the memorandum of understanding. While this degree of flexibility may exceed what is permitted under Hawaii law, it would be appropriate to allow agencies greater discretion within a single fiscal year.

Although the agreements would be negotiated between the Department of Budget and Finance and the affected agency, the Department should keep the Finance and the Ways and Means Committees informed about the progress of negotiations. Once a memorandum has been agreed to, it should be submitted to these committees and to the relevant subject matter committees for their review and comment. The Department of Budget and Finance should take account of this advice in negotiating the memoranda of understanding.

When the budget is seen as a contract for performance, the executive is expected to live up to its part of the bargain by providing the agreed-upon resources. Failure to do so may impel renegotiation of the terms of the agreement. If, for example, the governor were to restrict some of the appropriated funds, there might have to be a corresponding adjustment in the expected results.

The memorandum process can be used with the merged budget system without adding to administrative burdens. This process would give the Legislature a substantially more potent means of linking appropriations and results, and it would enable legislators to allocate incremental funds with greater awareness of the likely impacts on performance. Despite these advantages, it would be prudent to pilot test the procedure in a few agencies, following which a determination should be made concerning the feasibility of a broader implementation in Hawaii government.

Audit the results

Each memorandum of understanding is an agreement between the government (represented by the Department of Budget and Finance) and a spending agency. Although such negotiations are appropriately conducted by executive officials, the Legislature should be apprised whether the terms of the agreement have been fulfilled.

RECOMMENDATION NO. 6: Performance pursuant to memoranda of understanding should be subject to review by the auditor.

Such audits should cover both the resources expended and the results achieved by the agency. The purpose of the audit should not be to second guess the agreement, but to determine whether the two sides have lived up to its terms. The audit should compare actual and promised performance and ascertain whether the agency has accurately reported on the level and results of its activities.

Reduce risk of fraud, abuse, waste, and inefficiency

Within the wide array of government programs, some are much more susceptible to fraud, abuse, waste, and inefficiency than others. It would be prudent for the State to take steps to ensure that such high-risk programs are thoroughly reviewed on a continuing basis and that appropriate actions are taken to correct identified deficiencies in program or financial management.

RECOMMENDATION No. 7: The Department of Budget and Finance should develop a procedure for identifying and monitoring programs that have a high risk for fraud and waste.

A procedure for identifying and monitoring high risk programs might be modeled along the lines of the process established by the U.S. Office of Management and Budget (OMB) in 1990 to classify programs according to their potential for fraud and abuse. OMB has discovered, for example, that loan guarantee and insurance programs, such as those operated by the U.S. Department of Housing and Urban Development, may be particularly vulnerable to abuse.

As a result of the OMB effort, some 106 programs have been classified as "high risk." These generally fall into three main categories: (1) programs that entail the transfer of funds from the government to private recipients; (2) programs that have serious deficiencies in financial management practices; and (3) programs (such as nuclear waste disposal) that entail a substantial risk to public health and safety. The first two of these categories involve risks arising out of the expenditure of public funds; the third entails risks inherent in the program itself.

When a program is labeled "high risk," it does not mean that the program should be terminated or curtailed. Rather, special efforts should be made (1) to remedy any shortcomings leading to the risk, (2) to monitor each high-risk program carefully, and (3) to safeguard public funds.

The special monitoring procedures established by OMB during the past year are closely tied to preparation and implementation of the federal budget. Each agency responsible for one or more high risk programs must submit, as part of its budget request, a schedule showing corrective actions planned or under way to remedy or reduce risk, the means to verify correction of the weaknesses, the amounts to be spent for corrective action, and the critical milestones associated with the corrective actions. Furthermore, the agency's budget request should be supported by an explanation of the policy justification and analytical basis for the corrective actions, and the resources allocated to correcting the problem.

Conclusion

A merged process would have many advantages over the current arrangement. It would end the practice of maintaining two sets of books, one for displaying the budget and another for deciding it. A merged process would also bring the input and output sides of the budget together and spur legislators to make informed spending decisions in light of the estimated impacts on performance. Combining the two processes would reduce the costs and paperwork of budgeting, while providing legislators with more relevant information.

Attaining these benefits requires changes not only in the current incremental process, but in the PPB system as well. Each feature of the PPB system has to be examined to ascertain how it should be modified to suit the new arrangement. This examination is conducted in the next chapter, which recommends modification of the various documents now created in response to the PPB system.

Chapter 4
Streamlining the PPB Process

The Executive Budget Act of 1970 establishes the planning-programming-budgeting (PPB) system as the basis for budgeting in Hawaii. The act is unsurpassed as a statement of the purposes of PPB and as a blueprint for how this system should operate.

PPB System

The Executive Budget Act of 1970 is the only instance in American state government where a complete PPB system has been prescribed by law rather than by executive authority. Elsewhere, it has been feasible for the executive to modify PPB unilaterally, without prior legislative approval. In Hawaii, however, the prescribed PPB procedures can be changed only if the law itself is altered.

Evolution of the PPB system

PPB has been practiced with little change for the past two decades, with the exception of some simplifying modifications made in the mid-1970s, plus occasional modifications in the program structure and measures of effectiveness.

Rather than alter PPB, Hawaii budget makers have developed the supplementary information system described in the previous chapter. In this way, the State could have, it was thought, the best of both budgetary worlds: (1) an extraordinarily clear and comprehensive vision of PPB on paper; and (2) a highly useful incremental system in operation. With this dual arrangement, there has not been much incentive to revise the PPB law.

The system has survived for yet another reason. Hawaii budget officials have its procedures down pat. The Department of Budget and Finance and state agencies have all programmed their computers to make the potentially arduous task of preparing budget projections and performance measurements into a routine exercise.

Over the years, PPB has become less a way of defining State objectives and analyzing program options and more a means of assembling the vast quantities of data that are distilled into the prescribed budget documents. Although the program structure links the various activities that serve a common objective, it has been used less as a means of analysis and more as a means of making biennial appropriations and maintaining the financial accounts.

Problems with the PPB system

Problems with the PPB system are not principally in the law, but in the way its provisions have been implemented. Twenty years after enactment, the Executive Budget Act remains a state-of-the-art planning-programming-budgeting system. The act spells out how the system should operate, the types of data to be collected and used, the analyses and measurements to be performed, and the documents to be produced. It defines each PPB component with textbook precision. It would be hard to compose a more coherent statement of how budgeting should be conducted. In practice, however, the system contemplated in that act is far from reality.

- **The Multiyear Program and Financial Plan** is a line projection that is made with little thought and does not reflect policy developments.

- **Measures of Program Effectiveness** are dutifully reported, but they guide neither financial management in the departments nor budget decisions in the Legislature.

- **The Variance Report** does not meaningfully assess results or provide any useful insights for the legislative oversight function. It has become just one more requirement to fit into the biennial budget cycle.

The executive budget is an intimidating document. Needed information is difficult to find, and the extensive data are difficult to interpret. The problem is especially acute for legislators who must grapple with the budget during a brief session in which they must also deal with many other pressing legislative responsibilities.

Keeping and improving the PPB system

Perhaps the easy way out would be to abandon PPB altogether. However, there are at least three compelling reasons for retaining the PPB framework.

1. **Cost.** Because PPB serves as the formal basis of budgeting, dismantling it would entail the costly and burdensome installation of a new system.

2. **Familiarity.** Interviews conducted for this report found little support in either the executive or legislative branch for discarding PPB altogether. Instead, there is a feeling that PPB should be streamlined so as to make it more relevant to legislative needs.

3. **Potential usefulness.** Despite its relative disuse, PPB has a number of features which would greatly enhance the merged system recommended in the previous chapter. The Legislature

will be much better prepared to realize PPB's potential if a streamlined system were merged with the incremental system already in place.

The task of streamlining requires that each part of the PPB system be examined individually. Accordingly, the ensuing sections of this chapter recommend changes to divest PPB of less useful features. Some of the recommended changes might be accomplished through executive initiative, but a full merger of PPB and the incremental system will likely require legislative action.

Program Structure

Every budget process needs an accounting framework for making and recording expenditures. In Hawaii, this framework is provided by the program structure, which classifies approximately 300 program accounts into 11 major State programs. The Executive Budget Act defines a program as *"a combination of resources and activities designed to achieve an objective or objectives."* (Emphasis added.)

The act defines program structure as *"a display of programs which are grouped in accordance with the objectives to be achieved or the functions to be performed."* (Emphasis added.)

The grouping of programs by objectives deviates from standard budget practice, which is to group all accounts by the organizational units in which they are located. At the top of the structure, some programs cross organizational lines, whereas others do not. At the bottom, each account is located in a single department. Thus, the budget contains an environmental program, even though the State does not have an environmental department.

The items in the program structure are arrayed in hierarchical order. Eleven major programs at the top branch out into a larger number of intermediate programs, and a still larger number of lowest level programs. The number of levels in the program structure has not been standardized; some parts of the budget reach the program account at the third level, others reach it only at the fifth.

The lowest level of the program structure represents appropriation accounts. The Executive Budget Act specifies the types of information to be provided at the lowest level, where the most extensive documentation is required. These include cost data, six-year projections, narrative explanations, and program and effectiveness measures. Summaries of these data are supposed to be presented at each higher level in the program structure.

Problems with the program structure

The manner in which the programs are structured can also be a hindrance, as well as a help, to effective use of the budget documents by persons (including legislators) who are not budget specialists. For example, one cannot find the more than $200 million spent each year on Medicaid without knowing that this huge program (1) is part of the social services--not the health--program; (2) has program structure number 060203; (3) also has program identification number HMS-230; and (4) is part of a Level II program called "assured standard of living." To locate Medicaid in the 1989-91 executive budget, one must first roam through the program structure at the beginning of the document, then turn to page 1072, where the Level II programs are listed, and finally skip another 50 pages to page 1123, where the program expenditures for Medicaid are displayed.

RECOMMENDATION NO. 8: The program structure should be modified so as to (1) reduce the number of levels, (2) consolidate some small accounts and subdivide some large ones, and (3) possibly relocate some accounts.

It would not be difficult to get rid of the program structure. This could be done by regrouping the lowest level programs by the departments in which they are located.[1] Nevertheless, retaining a streamlined program structure would appear to be the most sensible course. One reason for this view is that Hawaii legislators and executive officials are familiar with the basic structure--the 11 highest-level programs--and know how to use it. Another reason is that the program structure sheds light on the linkage among the various activities of Hawaii government.

Reduce the number of levels in the program structure

Instead of discarding this structure, a number of modifications are suggested to make it less confusing and cumbersome, and to help focus legislative action on matters that have significant budgetary impact. The first part of the recommendation would reduce the program structure to fewer levels. Specifically, it would (1) reduce the structure to three levels and (2) eliminate the confusing identification codes by labelling these as *programs, subprograms,* and *program accounts.*

The current structure has as many as five layers, and some agencies go even lower for internal budget purposes. Of the lowest level programs, approximately 55 percent are at Level IV, and another 40 percent are at Level III. The remainder are scattered at Levels II and V. Little would be lost by getting rid of some *intermediate* program levels. These layers add to the bulk of the budget documents and make it harder to locate the information for which one is looking.

The health program typifies the uselessness of the intermediate levels. This section of the budget begins with a two-page presentation of Level I, whose main purpose is to summarize the Level II programs. This is followed by a two-page presentation of Level II, which summarizes the next level, then by yet another two-page Level III summary of the next lower level. Each of these three presentations has an identical heading: "Measures of effectiveness and summary of expenditures at next lower level programs." What this means is not self-evident, because no measures of effectiveness are in sight. Instead, there is a vacuous statement about the objectives of that level, along with arcane identification codes. Within the health program, it is only at Level IV that expenditure and performance data are displayed in sufficient detail to be useful for budgetary choice.

The recommendation would eliminate confusing references to particular levels from all budget documents. Phrases such as "lowest level" would no longer be used. This recommendation can be fully implemented without making detailed revisions in the Executive Budget Act. The act would continue to refer to intermediate programs, lowest level programs, and so on, but the budget documents would use only the three terms--programs, subprograms, and accounts--suggested here.

Each of the three categories would have a specific function in the budget. The *program* would summarize expenditures, not performance, for a broad area of governmental responsibility. The *subprogram* would be the level at which program priorities are analyzed and discussed. Accordingly, the program memoranda would be developed at this level. Finally, the program *accounts* would have detailed expenditure and performance data to enable the Legislature to make specific appropriations.

Consolidate small accounts

The second part of the above recommendation would combine some small accounts, while subdividing some of the large ones. Some accounts are so small as to call into question the need for separate appropriations. For example, TRN-903 (Coastal Areas) spends less than $20,000 a year, while HMS-807 (Teacher Housing) has only about $120,000. The latter immediately follows an account (HMS-220, Rental Housing Augmentation and Assistance) that has more than $20 million a year in operating funds.

Many small programs, especially in the transportation and hospital areas, are sliced into even smaller accounts in order for the Legislature to make separate appropriations for facilities maintained by the State on each island. There are other ways of earmarking funds for such facilities or programs without unduly complicating the account structure.

Subdivide large accounts

At the other end of the spectrum are accounts which comprise so many discrete activities that the Legislature cannot effectively control them. One example is HMS-111 (Services to Individuals and Families) which allocates about $40 million a year among 16 different activities. A related problem is that, in some major program areas, upwards of half of total expenditures are allocated to a single program account, with the remaining accounts having relatively trivial amounts.

As another example, more than $200 million of lower education expenditures are lumped into a single account: the Regular Instruction Program. It is exceedingly difficult for either the executive or the Legislature to make informed budget decisions for such huge catch-all programs.

Relocate some accounts

The final proposed modification would be the possible relocation of some accounts from one program area to another. The Medicaid program mentioned earlier (whose account title is Health Care Payments) might be a candidate for relocation. One should not have to thumb through the social services budget in search of hundreds of millions of dollars spent on health care.[2]

In the preceding discussion, the various examples of possible consolidation, subdivision, or relocation of accounts have been mentioned only to make the point that the program structure is in need of a thorough examination.[3]

The Department of Budget and Finance is urged to undertake a complete review of the program structure, along the lines suggested here.[4] All changes should be designed to make the budget documents useful and accessible to legislators and the public alike. The department should revise the structure only after consulting with the appropriate legislative committees.

Multiyear Program and Financial Plan

The executive budget combines two closely-linked components of the PPB system: (1) the executive budget for the next biennium and (2) the multiyear program and financial plan for two additional biennia.

Problems with the multiyear program and financial plan

The budget and the multiyear plan are integrated at all levels of the program structure. Every table (1) displays expenditure and performance data for the current biennium, (2) requests funds and estimates performance for the next biennium, and

(3) projects expenditures and performance for the subsequent two biennia. All this makes for a very dense and cumbersome document.

The format that has been developed for presentation of the budget is a marvel of informational compression and an obstacle to policy comprehension. At the program account level, hundreds of data elements are packed into each of the two main schedules: one for program expenditures, the other for program description. For each of the eight years covered by the executive budget and the multiyear plans, expenditure data are shown for the following:

1. Operating costs

   . personal services
   . other current expenses
   . equipment
   . motor vehicles

2. Capital investment expenditures

   . plans
   . land acquisition
   . design
   . construction
   . equipment and furnishings

For both operating and capital expenditures the means of financing is displayed: general funds, special funds, revenue bonds, federal funds, and so forth.

The numbers on the pages are so densely packed that a reader often misreads their value, especially when the numbers represent millions or tens of millions of dollars. Another complicating factor is that expenditures for the current and the next biennia are shown in dollars, while projections for the two succeeding biennia are in thousands of dollars.

The program description table accompanying each account is divided into as many as five subschedules: (1) measures of effectiveness; (2) program target groups; (3) program activities; (4) program revenues by type; and (5) program revenues by fund to which deposited.

The density of this page--and the corresponding ''unreadability'' factor--depends on the number of entries under each subschedule. With the budget instructions permitting as many as 30 performance measures (ten for each of the three types of performance), and each measure estimated for eight fiscal years, the number of data elements for each program account often exceeds 200 on this page alone.

RECOMMENDATION NO. 9: The executive budget document should concentrate on the biennium for which resources are being allocated. The program and financial plans should provide only summary financial projections for the later biennia.

The expenditure and financial information amassed in the program and financial plan might be worth the trouble if all the data were used. The overwhelming evidence is that they are not. At all stages of budgeting in Hawaii, attention is focused on the biennium immediately ahead. That is the period for which legislative decisions have to be made and resources allocated.

In light of the above findings, a selective approach is recommended on grounds that it would yield more useful information for the Legislature than the blanket requirement of multiyear projections for every level and account in the budget.

The readability of the executive budget would be considerably enhanced by making the following small adjustments in the budget schedules:

1. At present, the number of positions is listed at the top of the schedule and repeated again at the bottom of the page. Eliminating one of these entries would not reduce the amount of information provided to the Legislature.

2. Each program now has both a program ID and a program structure number. The latter can be dropped without any loss in the ability of users to locate budgetary information.

3. Some outlays are labeled ''costs,'' others are designated ''expenditures.'' More consistent terminology would improve the clarity of budget information.

Problems with outyear data

The multiyear program and financial plans have not lived up to the expectations of the 1970 PPB law. The framers of the PPB system envisioned multiyear planning to be as follows:

> The process by which government objectives are formulated; measures by which effectiveness in attaining the objectives are identified; alternatives by which objectives may be attained are determined; the full cost, effectiveness and benefit implications are determined; and the cost and effectiveness and benefit tradeoffs of the alternatives are identified.

Over the years, however, the multiyear plan has become a straight-line projection of expenditure and performance. The expenditure forecast builds in an inflation rate, but it usually fails to take account of, or project, any changes in either policy or workload. Performance projections show no evidence of care in their preparation. In most cases, effectiveness levels are projected to remain unchanged over the full six-year budgeting and planning period. The extensive data that are presented in the multiyear program and financial plan enable it to conform to the letter of the law while totally ignoring the spirit of the law.

Focus budget decisions on the next biennium

Legislative budget decisions are already focused entirely on the upcoming biennium. The executive budget should have the same focus.

For reasons discussed above, expenditure and performance projections for the years beyond the next biennium would no longer be required for individual program accounts. Deleting the four outyear columns in their entirety would make the executive budget a much more legislator-friendly document while freeing space for material on the next biennium. Expenditure and other budget data would be more accessible,[5] and the abbreviated entries for many of the performance measures could be made more intelligible. There would be space for additional material on program changes, trends, and current issues.

The intent of the recommendation here is not to banish multiyear data from the budget altogether. First, as noted in the ensuing discussion, a multiyear capital improvements plan would continue to be required. Second, for operating costs, outyear projections would be provided selectively, *in summary form,*[6] at the subprogram level for three purposes: (1) projections of total revenues and expenditures; (2) trend analysis of major issues and developments; and (3) estimates of the future budgetary implications of program changes.

The first of these is important for estimating whether projected revenues will cover the policies and programs funded in the budget. These projections would deal solely with financial trends; they would not estimate future performance levels. It would be useful to disaggregate these projections by subprogram to show trends within the major areas of the budget.

The program memoranda should contain trend analysis of major issues and developments, especially as these pertain to program change requests. These projections would be made selectively only for those subprograms which are judged to need a careful look at future prospects. They could be presented in statistical tables, or they could be incorporated into the narrative explanations, as appropriate.

The capital improvement program (CIP) would continue to be presented on a multiyear basis, as is the practice in many other states. The CIP would still be broken down by plans, land acquisition, design, construction, and equipment and furnishings so as to show how each project is expected to progress during the six-year CIP planning cycle.

Link major program change requests to performance

Finally, every major program change request should be accompanied by a probing analysis of future expenditures and performance. This is the part of the budget where careful consideration of the future is of utmost importance to the Legislature. When legislators are asked to initiate or expand programs, they should be aware of all future costs into which the government may be locked, as well as the results that are expected to be achieved in the next four to six years.

Performance Measures

Three types of measures are currently included in the executive budget and the program and financial plan.

1. **Program activity measures** of the volume of work performed or the services provided by each program;

2. **Program target group measures** of the population eligible for, or that would benefit from, the service; and

3. **Measures of effectiveness**, which gauge the degree to which the objectives sought are attained.

Evolution of effectiveness measures

During the early years of PPB, considerable effort was expended on selecting pure measures of effectiveness on the basis of analytic criteria. Initially, insufficient consideration was given to whether relevant data were available or to the cost of securing the desired information. As the PPB system evolved, however, it was deemed sensible to devise measures for which reliable data were routinely available.

Many of the measures currently published in the executive budget have been developed carefully and with considerable sophistication. They are among the most advanced published by American state governments. It has been a disappointment, however, to find little indication that the measures are used in making or implementing budget decisions.

Problems with effectiveness measures

The failure to use the effectiveness measures in the budget probably has more to do with their loose connection to budgetary issues than with their quality. To begin with, there are too many measures for busy legislators to cope with during the brief period they have for work on the budget. With as many as 30 measures for each account--most have fewer, however--the budget conveys the impression that managers have not sorted out what is really important in gauging how well their programs are doing.

Second, over the years, preparing the measures has become a rote exercise, just one of the many things agencies have to do in filling out their budget requests. This tendency is reinforced by the fact that the measures are not adjusted to address the particular concerns of each budget cycle. With few exceptions, the same measures are applied each time.

Third, few of the measures are expressly linked in the budget to the cost of providing the services or meeting the objectives. Significantly, the program memoranda rarely refer to data found under the measures of effectiveness. *Even more important, the budget is virtually bereft of unit-cost and cost-effectiveness measures.* The lack of cost measures renders it impossible to calculate what a change in resources might portend for workload or effectiveness.

Finally, many of the measures are difficult to read and interpret. The budget is full of so many arcane abbreviations that it sometimes appears to be written in a foreign language.

RECOMMENDATION NO. 10: Each account should be limited to a total of ten performance indicators. Some of these should measure the cost of each unit of service or effectiveness produced, and others should indicate the quantity of change or improvement sought in the program.

In measuring performance, the Hawaii budget process should be guided by the principle that less can be more. As in other aspects of the PPB system, a selective approach is recommended to identify those indicators of performance which directly pertain to the budget choices at hand. Many of the measures currently in use will likely be continued, but it would be extremely worthwhile to review existing measures and introduce some new ones designed to link the cost and performance sides of the budget.

Develop improved effectiveness measures

It would be appropriate to make fuller use of measures devised by each agency to monitor its own performance. One complaint voiced by agency officials is that the performance measurement system holds them accountable for matters over which they have no control, such as social problems or the overall condition of the economy. The internal management information or performance measurement systems maintained by agencies generally distinguish between outcomes that result from their actions and those which derive from broader social and economic forces. The new ''school performance report card'' devised by the Hawaii Department of Education distinguishes between context indicators which are generally beyond the school's control, improvement process measures of the actions taken by the schools, and outcome indicators which measure results.

A sustained effort should also be made to measure the average or marginal cost of producing units of effectiveness or other outputs. Without such measurements, government departments will not be able to estimate the incremental costs of providing additional services, and the Legislature will not be certain of what it is buying when it makes appropriations.

In many cases, effectiveness can most appropriately be measured in terms of expected or achieved changes in outcomes. Effectiveness always denotes *a change from what would occur in the absence of the expenditure or activity*. This means, for example, that if the program were to be eliminated, all achievements shown under the measures of effectiveness would presumably cease to exist. This concept is fundamental to the design of effectiveness measures, and should be used as a criterion to evaluate the different measures of effectiveness found in the budget documents. Some of the data shown under ''measures of effectiveness'' are, in fact, nothing more than statistical data that (1) in one way or another, may be related to the program, but (2) do not measure, or even describe, accomplishments of the program itself.[7] Moreover, the relevance of such statistical data to program activities or workload is, at best, unclear.[8]

If an outcome would occur even without the expenditure, it would not be appropriate to credit (or blame) the agency for the result. Data that record such outcomes should not be displayed under measures of effectiveness. Thinking of effectiveness in terms of the changes that ensue from government programs should lead to a recasting and improvement of effectiveness measures.[9] The idea behind these measures is that agencies should strive to enhance their performance with the resources already at hand, and that they should view improvement as a fundamental responsibility of management. A separate category of such measures could cover improvements in the form of productivity gains, greater progress in achieving objectives, or other measurable results.

Link resources, workload, and performance

The common denominator between inputs, program activities, and outputs is money, that is, the budget appropriation. The linkage between inputs and different budget levels is usually straightforward. Virtually everyone understands that more money enables the purchase of more inputs. Conversely, less money restricts inputs.

The linkage between inputs and workload levels is also fairly direct and straightforward. More inputs should mean a greater work output. Similarly, an increase in the workload level will typically require more inputs.

It may be more difficult to link program effectiveness with workload levels, the inputs consumed by the program, and the budget appropriation. The difficulty does not in any way diminish the need to establish the linkage. The end result of this linkage is what is usually referred to as *cost-effectiveness.*

To illustrate the linkage between program effectiveness and inputs, workload and performance, as well as the concept of cost-effectiveness, consider the tuberculosis (TB) program in the Department of Health. A major activity of that program consists of administering skin tests and chest x-rays to various groups of people to ascertain whether any of them have TB. The TB program screens about 50,000 people annually. This screening activity comprises an important part of the program *workload.*

The number of TB cases found via the screening activity is an important measure of program *effectiveness.* Each year the screening activities identify about 35 cases of TB. Thus, on average, the TB program finds one case of TB among each 1,400 people screened. The *cost-effectiveness* of the screening activity is the cost of finding one case of TB, and is equal to the cost of screening 1,400 people. In the context of program budgeting, the cost of screening 1,400 people refers to the *full program cost*, which includes (1) the cost of all inputs (labor, materials, travel, etc.) used to administer the test, (2) all laboratory costs incurred to process the tests,[10] (3) all follow-up costs of recording results and notifying people and organizations of the outcome of the tests, and (4) any other miscellaneous costs associated with screening activities. To illustrate the linkage between costs, workloads and effectiveness more concretely, *assume* that the full program cost of TB screening amounts to $1 million annually. For 50,000 people, this amount would represent an average of $20 per person screened. Under this assumption--and it is merely an expedient assumption to facilitate illustration of the concept--the cost of finding one case of TB via the screening program amounts to $28,000.[11] This datum, $28,000 to find an active case of TB via the screening program, is an illustration of a cost-effectiveness measure.[12]

Link productivity and cost-effectiveness

Increased productivity typically means doing more with the same (or fewer) resources. The hypothetical example from the TB program, discussed above, can be used to illustrate this concept. Suppose that some new technology or equipment is found that will enable TB tests to be administered and processed with fewer resources and at less expense. Suppose that the new technology enables a 10 percent reduction in the average cost, from $20 to $18. TB tests could then be administered to 50,000 people for $900,000, instead of $1 million. Under such circumstances, it would be customary to say that productivity has increased. Assuming that 1,400 tests continue to result in discovery of one case of TB, the cost of finding one case would then be $25,200 (down from $28,000). From this illustration, it can be seen that an increase in productivity will, other things being equal, improve the measure of cost-effectiveness. A focus on cost-effectiveness thus includes, or subsumes, increases in productivity.

Importantly, cost-effectiveness also goes beyond mere changes in productivity. To illustrate this point, let us extend the above example from the tuberculosis program. Suppose that the program determines that it is no longer necessary to administer skin tests to 5,000 of the 50,000 people tested annually. In other words, it is determined that 10 percent of the tests can be dispensed with altogether, with no reduction in the number of cases of TB that are likely to be identified. Instead of testing 1,400 people to find one case of TB, only 1,260 people would need to be tested. Under these assumed circumstances, the average cost per test would still be $20, indicating that the "ordinary" productivity associated with individual tests has not changed. At an average cost of $20, the cost of testing 1,260 people to find one case of TB would be $25,200. The cost-effectiveness would thus improve by virtue of eliminating the cost of tests that are no longer necessary. This hypothetical example illustrates the important point that cost-effectiveness includes, but goes beyond, ordinary measures of productivity.[13]

New Publication to Highlight Budget Developments

The executive budget is an inherently complicated and dense document. Even if all the simplifications recommended in this chapter were implemented, the amount of detail contained in the budget would still be enormous. This detail is necessary for the Department of Budget and Finance and the money committees to perform their responsibilities, but it inhibits many legislators and others from comprehending the spending policies and priorities reflected in the budget.

RECOMMENDATION No. 11: The Department of Budget and Finance should publish a summary of the budget that highlights major developments and key issues. This new document should make creative use of graphics and should be widely distributed to legislators, the media, and interested citizens.

The Legislature has a pressing need for a summary document that highlights major trends and important financial issues in each of the State's programs. The Department of Budget and Finance should endeavor to create a comparatively short, exemplary document that would be much more informative *and communicative* than a standard ''budget-in-brief.'' Modern graphics, color, and other state-of-the-art communication techniques should be employed to provide a clear yet concise picture of what the State is doing in each major area of responsibility. Virginia's award-winning, sprightly document might be a model for a similar publication in Hawaii.

In less than 50 pages, the Department of Budget and Finance should aim to tell the State's budget story in a non-technical language targeted to legislators, the press, and the public. The new document would emphasize trends which affect the demand for State services, such as demographic and economic conditions. It would dramatize the impact of federal policies in areas such as Medicaid and other entitlements in the State budget, and would point to the relationship between Hawaii State government and local finances.

There would be no need to go into technical detail, because that would continue to be provided in the executive budget and other documents. Presentation should focus on each of the 11 major State programs and on cross-cutting issues that affect overall State conditions.

The document should be available for distribution to legislators at the start of the session. Sufficient copies should be printed for distribution to the media, local governments, interest groups, and others.

Program Memoranda

At present, one program memorandum is prepared for each of the 11 major programs in the budget. Although the memoranda vary considerably in length, they follow a fairly standard format and add up to more than 300 pages of documentation. Much of the material is appropriately organized around Level II subprograms.

The executive budget also has a standard format that combines statistical and descriptive information. In the executive budget, however, most of the material contained is provided at the lowest level program accounts. The nature of the information in the two documents is compared in Table 4.1. This comparison indicates the extensive amount of overlap that currently exists.

In Chapter 3, it was recommended that there be better integration between the program memoranda and the other budget documents, both to avoid duplication of effort and to improve the likelihood that this material will be used by the Legislature. To the extent that the program memoranda contain purely descriptive material not already included in the budget, such material should be deleted from the program memoranda and consolidated with the budget narrative.[14] The program memoranda should also eliminate duplicative expenditure and performance data, except as they are pertinent to the discussion and presentation of critical issues, trends, and choices warranting legislative attention. These steps will shorten the program memoranda and focus them more precisely on the program and budget issues facing the Legislature.[15]

RECOMMENDATION NO. 12: The program memorandum should focus on explaining critical issues, priorities, and program change requests contained in the budget. Care should be taken to target these statements to current legislative concerns and to avoid unnecessary duplication of material in the executive budget.

There should be an effort to make the program memoranda the key documents in the budget submission. The various narrative statements should become more focused and specialized. As suggested previously, narrative statements in the program memoranda should respond to any questions posed by the interim inquiries process and should also relate information from program change requests to the budget issues confronting the Legislature. All major program change requests should be supported by data estimating the change in performance that

TABLE 4.1
Types of Material in the Program Memoranda and the Executive Budget

Program Memoranda	Executive Budget
STATISTICAL DATA	**STATISTICAL DATA**
Costs of the Recommended Program	Program Expenditures
Selected Measures of Effectiveness/Activity	Measures of Effectiveness, Program Target Groups, and Program Activities
	Program Revenues by Type and by Fund
NARRATIVE STATEMENTS	**NARRATIVE STATEMENTS**
Overview	Statement of Program Objectives
Program Change Recommendations	Description of Activities Performed
	Statement of Key Policies Pursued
	Identification of Important Program Relationships
Emerging Conditions, Trends, and Issues	Description of Major External Trends Affecting the Program
Costs and Effectiveness of the Recommended Programs	Discussion of Cost, Effectiveness, and Program Size
	Discussion of Program Revenue
Selected Problems for Possible Study	Summary of Analysis Performed
	Further Considerations

would ensue from the proposed change in expenditures. The governor would continue to have the option of supplementing the budget documents with additional submissions, such as major analytic studies and other reports.

Variance Report

The variance report was one of the most innovative features of the original PPB system. The concept is quite simple: actual expenditures and results should be compared to budgeted levels, and significant variances between the two should be explained. Despite its apparent simplicity, however, the variance report has had trouble finding a niche for itself. It appears that neither legislators nor budget officials know what to make of it.

Shortcomings in the variance report

In its present form, the report has a number of conspicuous shortcomings, but these do not account fully for the low esteem in which it is held. One problem is incompleteness. Reporting for the previous year is incomplete, and the report does not do a good job of indicating what occurred, or what failed to occur.

Another problem is timing--variances are reported too late for the last completed fiscal year and too early for the year in progress. The variance report is published about six months after the last fiscal year ended, too late to intervene when actual results veer substantially from budgeted levels. The report also shows results for the first three months of the current fiscal year and estimates results for the next nine months.

In the private sector, variance reports are designed to provide an early warning of problems and to permit timely corrective action. In Hawaii, however, all that is required is a brief explanation of the variance without any statement as to any corrective steps that will be taken. The report does not provide any meaningful ''flags.'' It does not trigger any action, nor does it feed directly into the next round of budget decisions. In its present form, the variance report does not appear to be useful to the Legislature, to executive agencies, or to the interested public.

RECOMMENDATION NO. 13: The variance report should be revised to report on the flow of expenditures in each program account and on selective performance results for the previous completed year.

The easy solution to the problems of the variance report might be to terminate it altogether and to make do with one fewer set of documents. Because of the considerable interest in reporting on financial results, however, this course is not recommended. With appropriate adjustments, the variance report can become a useful instrument for tracing the flow of funds from appropriation through disbursement. There is reason to expect the Legislature to have considerable interest in this type of information. One of the features of the testimony submitted by each department to the House Finance and the Senate Ways and Means Committee is a statement of adjustments made in authorized expenditures for the year in progress.

Eliminate current-year data

It is recommended that the financial portion of the variance report be modeled along the lines prescribed for testimony on financial results. Rather than dealing with the current fiscal year, however, it would show the flow of funds in each program account for the last completed fiscal year. No longer would this report contain data pertaining either to the first three months of the current fiscal year, or to projected performance for the next nine months.[16]

Reduce the number of pages

As envisioned here, the variance report would display a one-page summary for the subprograms within each major program, without any narrative explanation. The total for the subprograms would constitute a succinct summary for the entire program. There would no longer be individual variance reporting at the subprogram level.[17]

Expand reporting on financial results for the prior year

For the fiscal display in the revised variance report, the first column would show the amount appropriated for each account. Subsequent columns would display the amounts added by collective bargaining augmentation, transfers in or out, amounts restricted by the governor, the total amount *actually disbursed* from each account, and the status of funds not disbursed (that is, lapsed or encumbered.)

Expand reporting on vacant positions

With regard to positions, the display would continue to show the total number of positions authorized, and the number of vacant positions as of June 30. In addition, it would also indicate how many of the unfilled positions were vacant for at least nine months preceding June 30.

Explain significant variances in expenditures

On the expenditure side, the narrative portion of the variance report should expressly focus on significant variances, such as those resulting from restrictions, transfers and unspent balances. The status of all major encumbrances as of the date of the report should be explicitly explained. The explanation should indicate (1) when all encumbered funds are expected to be disbursed and (2) whether any of the encumbered funds are expected to lapse.

It is recommended that the variance report show all expenditures and encumbrances *as of September 30, three months after the end of the fiscal year.*

Explain long-term vacancies

As regards position vacancies, the narrative should (1) state which positions that were vacant for more than nine months on June 30 have been filled at the time the variance report is prepared and (2) explain why the agency cannot fill positions that were vacant for at least nine months on June 30 and remain unfilled at the time the report is prepared.

Focus on significant deviations

Routine variances from original appropriations, those that arise from collective bargaining augmentation, transfers, and so forth, would be detailed in the body of the data display. Accordingly, the narrative analysis would not explain every variance between budgeted and actual performance. Instead, it would focus on significant variances between budgeted and actual performance, as well as on selected issues requiring further attention.

Conclusion

The recommendations in this chapter are based on a conviction that budget information can be made more useful to legislative needs, while at the same time effecting a material reduction in the volume that is submitted.

In addition to creating a new document that would highlight budget developments, an assiduous effort should also be made to improve the clarity, readability and presentation of all budgetary data, as well as the substance of the narrative discussion in the executive budget. The program memoranda should focus on budgetary issues and choices facing the Legislature during the next biennium. Charts, figures and other graphic techniques should be used to make all budget documents more communicative. Program performance and cost-effectiveness should be stressed. Such improvements will help the Legislature make more informed and effective decisions on existing and new programs.

Notes

Chapter 1

1. The PPB law, Act 185 of 1970, is codified in Chapter 37, HRS.

2. National Conference of State Legislatures, *Strengthening Legislative Capacity: A Study of the Hawaii Legislative Service Agencies*, by Karl T. Kurtz, Corina L. Eckl, Jo Anne B. Martinez, and R. Dale Cattanach, October, 1989.

Chapter 2

1. The failure to give adequate recognition to potential problems in demand may have arisen from economists' faith in Say's Law, which says that supply creates its own demand. Say's Law is applicable to markets for ordinary goods, but it appears to be less applicable to "information." As the experience of the Hawaii Legislature indicates, an overabundant supply of information, rather than creating demand, may simply cause recipients to ignore the supply altogether.

2. It is unreasonable to expect government employees temporarily on loan from executive agencies to take an overly critical view of budget submissions. They would have an inherent and untenable conflict of interest vis-a-vis their permanent employer.

3. The budget submitted pursuant to Chapter 37, HRS, is not an example of demand-based information, because it does not respond to specific questions or concerns of the Legislature.

4. In order to address the broad issues raised in H.C.R. No. 202, legislators need to have more opportunity to ask "the right questions." In the hectic pace that accompanies each legislative session, a question never asked is likely to be a question never answered. No process can guarantee that legislators will ask the right questions; it can only enhance their opportunity to do so.

5. The exact format for responses should be coordinated by the Department of Budget and Finance. Responses could be contained in the program memoranda, the director's testimony, or in a separate submission(s). Since the types of questions may vary considerably, a uniform format may not be appropriate. Some questions might conceivably require special analytic studies, which could be submitted separately.

Chapter 3

1. Legislative committees would be given additional line item details on request.

2. In Colorado, the memorandum of understanding is signed by the chairman of the Joint Legislative Budget Committee, but the more common practice is for it to be signed by executive officials.

Chapter 4

1. Each program account is already assigned an alpha-numeric code, with the three letters of the code identifying its organizational location.

2. Facility in using the budget documents might also be improved by providing cross references or one- or two-line summaries at appropriate places.

3. Under the recommendation made here, it is envisioned that the education program would be subdivided into two programs: (1) higher education and (2) lower education. The former would encompass the University of Hawaii system, and the latter would encompass elementary, secondary, and adult education.

4. It is not the intent of this recommendation to effect a material increase or decrease in the number of program accounts, but rather to increase the usefulness of the program structure within the existing parameter of about 300 program accounts.

5. The expenditure and budget data could be made far more readable simply by inserting the customary commas, to indicate thousands, in the data.

6. It is envisioned that outyear projections of operating costs for all subprograms within a program would be presented in the space of one or, at most, two pages.

7. This is especially true of the data found under "measures of effectiveness" in the displays at the intermediate program level.

8. In terms of the criteria advanced here, some of the so-called measures of effectiveness found in the budget documents can fairly be described as meaningless or irrelevant. The inclusion of such information adds little, except clutter, to the budget presentation.

9. Attention to effectiveness measures should help the Legislature to sort out its priorities within and between programs. Programs that cannot devise good measures of effectiveness might be candidates for reduction or elimination.

10. The cost of operating the department's laboratory is listed as a separate program; hence laboratory costs are not reflected in the TB program budget.

11. The cost of testing 1,400 people at an average cost of $20 per person.

12. This $28,000 is a hypothetical figure. The average cost of screening cannot be ascertained from the budget data as presented.

13. If the average cost of testing one individual could be reduced from $20 to $18, and the number of people necessary to test to find one case of TB could also be reduced from 1,400 to 1,260, the cost of finding one case of TB would be reduced to $22,680.

14. When consolidating the descriptive material now contained in the program memoranda with that in the budget, serious consideration should be given to eliminating some of nine types of narrative statements that now accompany each account. Most of the statements are brief, lack analytic depth, and merely repeat material (sometimes with cosmetic updating) published in previous budgets. It would be better to divide the narratives into fewer pigeonholes and to concentrate on providing a clear explanation of programs, expenditures, and performance trends shown in the budget.

15. It is conceivable that the program memoranda might be included in the Executive Budget, depending on their length.

16. Every account in the variance report also includes a line designated as "research and development." This space has been blank (zero) in every variance report published during the 1980s. Indicating that no money is identified as being spent on research and development serves no useful purpose whatsoever. Creating room for such nonexistent expenditures needlessly compresses the rest of the page. It is therefore recommended that the requirement to single out expenditures for research and development be eliminated.

17. Eliminating the display at the subprogram level will substantially reduce the number of pages in the variance report, with no meaningful loss of information whatsoever.

Response of the Affected Agency

Comments on Agency Response

A preliminary draft of this report was transmitted on January 14, 1991, to the Department of Budget and Finance. A copy of the transmittal letter is included as Attachment 1. The Director of Finance responded by letter dated February 6, 1991, and is included as Attachment 2. We asked the authors of the report, Dr. Allen Schick and Dr. John Haldi, to review the director's response, and the following are their comments.

It is most gratifying to learn that the Department of Budget and Finance has no serious objections, and agrees generally with recommendations affecting the program structure, the executive budget document, the variance report, performance indicators, and other budget information. Throughout, our assumption has been that, prior to enactment of any legislation, specific changes in the budget submission would be discussed with the appropriate executive agencies, as suggested by the Director of Finance. Implementation of these recommendations should help "to strengthen the legislature's capacity to determine the appropriateness and productivity of state programs," an important objective of H.C.R. No. 202.

Budgeting is a shared responsibility of the executive and legislative branches. The Legislature has the constitutional authority to provide for the revenues of the State and to make appropriations. The Executive has responsibility to prepare the budget, inform the Legislature of the Governor's recommendations, and manage State programs and resources.

This constitutional division of power is predicated on the Legislature's having sufficient information for carrying out its budget responsibilities. The Executive Budget Act (Act 185 of 1970 as amended) imposes detailed responsibilities on the Department of Budget and Finance to inform the Legislature about budgetary matters. Our report will simplify these reporting requirements and would not require the submission of any material which is not already used in making budget decisions.

We agree fully that whatever changes are made to the budget process should maintain the constitutional and functional integrity of the legislative and executive branches of government. It is our view that none of the recommendations would infringe on the prerogatives of either branch.

The director's letter raises several concerns that need to be discussed. The following sections, which follow the sequence of the comments contained in the director's letter, address several of the points he raises and provide assurance that Budget and Finance's interests are not injured by the report.

Integration of the PPB System and the Incremental System

The director's observation that executive agencies tend to be highly protective of their current funding level is undoubtedly correct. Nevertheless, the current funding level of programs should not be considered sacrosanct and exempt from legislative review. As our report recommends, legislative review of the budget should be structured so as to facilitate the reallocation of resources between programs.

Focusing on tradeoffs between the least effective program components is a rational means of overcoming entrenched attitudes in executive agencies. Consequently, whether the legislature is reviewing budgetary priorities or acting in its oversight capacity, from time to time it will have good reason to examine program effectiveness at various levels of funding.

Our report does not strengthen the tendency toward incrementalism. *The incremental system already exists and is used in both branches when making budget decisions.* Pretending that it does not exist greatly adds to budgetary workload. Integrating the PPB system with the incremental system would reduce the burden of preparing and reviewing the budget and enhance the capacity to reallocate resources.

It is not the intent of any of our recommendations to preclude the administration from using a "functional-policy" approach--or any other approach, should it so desire--for its internal review of the various programs administered by the different departments. The recommendations in our report are concerned solely with presentation of the budget to the Legislature, and review of the budget by the Legislature.

Memoranda of Understanding With Executive Agencies for Expenditures and Performance

As pointed out in the director's letter, our proposed memoranda of understanding would explicitly recognize the mutual obligation that is implicit in the current A-19 (Allotment Advice) process. In our view, this would improve the A-19 process. The recommendation to use memoranda of understanding to enhance agency performance (p. 22) contemplates that all negotiations will be between the affected agency and the Department of Budget and Finance, acting on behalf of the executive. The report does suggest that the Finance and Ways and Means Committees be kept informed concerning the negotiations. The consultation contemplated in our report is quite similar to discussions frequently held between executive officials and legislative committees and their members concerning the intent of legislation. It would not violate the constitutional separation of powers.

Prior to statewide implementation, pilot testing of the concept should be undertaken (see p. 24). In this way, implementation problems can be kept to a manageable level and resolved, while gaining experience with this technique to improve agency performance. Since memoranda of understanding would be negotiated just prior to the beginning of the fiscal year, the State's financial outlook, especially for the forthcoming twelve months, would be somewhat clearer than it is at the time of budget preparation. It is, of course, essential that the Executive be able to respond to revenue fluctuations and changes in the State's financial condition. None of the currently available powers would be diminished by the memoranda of understanding. However, as the report notes at p. 24, modification of a memorandum of understanding might also require an explicit adjustment in the expected performance.

Improving program performance by measuring results should be an ongoing process in all executive agencies. It is our impression that many programs have developed adequate performance measures. For those programs where the absence of effectiveness measures is a significant problem, the issue needs to be met head-on. Explicit incorporation of such measures into a memorandum of understanding (or the A-19 process) will provide all parties with a strong incentive to further improvement.

Budget and Finance to Develop Procedures for Identifying and Monitoring Programs That Have a High Risk for Fraud and Waste

The federal effort to identify programs that are more susceptible to fraud and waste is comparatively recent. The discussion that accompanies recommendation No. 7 (p. 26), concerning OMB's criteria and categorization of federal programs, is intended for illustrative purposes only.

The OMB approach needs to be adapted, in a pertinent way, to programs operated by the State of Hawaii. To respond to the point raised in the director's letter, ''high risk'' includes but extends beyond the usual issues of budget expenditure and compliance. For example, state operated programs that give loan guarantees, assume insurance-type risks, or support commercial real estate type developments may involve high risks that are not directly reflected in an agency's budget.

Our recommendation calls on Budget and Finance *to identify*, using whatever criteria they deem appropriate, those state programs judged to have a somewhat higher than average potential for fraud and abuse. We concur fully with the director that departments with statutory responsibilities over such programs should be primarily involved in developing plans and taking appropriate actions to reduce the risk.

Program Memoranda to Address Legislative Concerns

The Legislature has a limited time in which to review and approve the budget. It is essential that the budget documents submitted to the Legislature focus attention on the review of performance, program and financial alternatives, and budgetary decisions. Once this need is met, the perspective can, of course, be widened to include executive concerns that go beyond legislative concerns. The purpose of our recommendation is to assure that the program memoranda satisfy the minimal legislative requirements.

ATTACHMENT 1

STATE OF HAWAII
OFFICE OF THE AUDITOR
465 S. King Street, Room 500
Honolulu, Hawaii 96813

(808) 548-2450
FAX: (808) 548-2693

COPY

January 14, 1991

Mr. Yukio Takemoto, Director
Department of Budget and Finance
State Capitol, Room 411
Honolulu, Hawaii 96813

Dear Mr. Takemoto:

Enclosed are three copies, numbers 6 to 8 of our draft report, *Legislative Review of State Programs*. We ask that you telephone us by January 18, 1991, on whether you intend to comment on our recommendations. If you wish your comments to be included in the report, please submit them no later than January 28, 1991.

The Governor and presiding officers of the two houses of the Legislature have also been provided copies of this draft report.

Since this report is not in final form and changes may be made to it, access to the report should be restricted to those assisting you in preparing your response. Public release of the report will be made solely by our office and only after the report is published in its final form.

Sincerely,

Newton Sue

Newton Sue
Acting Legislative Auditor

Enclosures

JOHN WAIHEE
GOVERNOR

YUKIO TAKEMOTO
DIRECTOR
Eugene S. Imai
DEPUTY DIRECTOR
THOMAS I. YAMASHIRO
DEPUTY DIRECTOR

EMPLOYEES' RETIREMENT SYSTEM
HAWAII INC
HAWAII PUBLIC EMPLOYEES HEALTH FUND
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PUBLIC UTILITIES COMMISSION

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BUDGET, PROGRAM PLANNING AND MANAGEMENT DIVISION
FINANCIAL PLANNING AND POLICY DEVELOPMENT DIVISION
INFORMATION AND COMMUNICATION SERVICES DIVISION
TREASURY OPERATIONS DIVISION

February 6, 1991

Mr. Newton Sue
Acting Legislative Auditor
State of Hawaii
465 S. King Street, Room 500
Honolulu, Hawaii 96813

Dear Mr. Sue:

This is in response to your request for comments regarding the preliminary report issued by your office entitled "Legislative Review of State Programs" which we received on January 14, 1991.

Rather than addressing recommendations individually, we would like to comment generally on what we considered to be key concepts and proposals advanced by your review.

Integration of the PPB System and the Incremental System

While graphically useful for internal agency reviews, the incremental approach has not generally been recommended by this administration for statewide use. Our experience has shown that the approach unavoidably provides a "visual argument" via format, which presumes that programs require a certain funding level (current funding) to maintain its reason for existence, and that significant adjustments are only a consideration at other funding levels (PCRs, workload). Consultant suggestions that the merged approach will facilitate meaningful tradeoffs in the current funding levels have already been shown to be unrealistic in practice. Departments have been most unyielding when it came to adjusting their current funding levels, because this level is perceived as the very essence of their programs. Any adjustments here would be seen as a threat to both the program's purpose and existence. Thus, from a (statewide) policy standpoint, "incrementalism" represents an attitude of entrenchment which can be especially restrictive during times of economic fluctuation or stress, or during times of government reform, when major decisions must be made which entail significant reallocations of program resources and statewide priorities. As a more practical alternative, this administration has chosen to pursue a broader, functional-policy approach, which will assess the need for the program itself, rather than assess its effectiveness at various levels of funding.

Memoranda of Understanding with Executive Agencies for Expenditures and Performance

The procedure proposed by recommendation no. 5 specifically expands on the intent of the current A-19 (Allotment Advice) process, but with precise contractual obligations and identified promises of performance. The current A-19 process only implicitly recognizes this mutual obligation. With the statewide application of such contractual arrangements covering two years of a biennium, however, we foresee the following legal and implementation problems. It affords less control and flexibility when revenues fluctuate significantly; it has no effective remedy for breaches; it does not include the executive in its deliberations and thus thwarts the constitutional power of that office; it allows selected representatives of the Legislature to participate in executive policy functions without the required approval of its colleagues, in contravention of Article III of the State Constitution; and despite its good intentions, it does not effectively address nor resolve the basic problem of the absence of good measures of effectiveness.

Budget and Finance to Develop Procedures for Identifying and Monitoring Programs That Have a High Risk for Fraud and Waste

The three "high risk" categories identified by the consultants should not involve only the Department of Budget and Finance, but other departments which have statutory responsibilities over such areas. For example, the Departments of Health and Accounting and General Services would be two such agencies. Further, we find the parameters established by the consultants to be inconsistent and without reasonable basis. We had assumed incorrectly, apparently, that "high risk" alluded to issues of problematic budget and expenditure compliance. As this is not the case, then other categories which entail liability (i.e., risk management) should also be considered.

Program Memorandum to Address Legislative Concerns

Recommendation No. 12 suggests that the Program Memorandum should focus on explaining critical issues, priorities, and program changes contained in the budget, with current legislative concerns being targeted by such statements. In this instance, we would object to the presumption that legislative concerns should be the defining criteria of information presented in this executive document, as it will inappropriately restrict executive initiative and confine the perspective of the program memorandum to a strictly legislative point of view.

In general, we had no serious objections with respect to proposed recommendations affecting the program structure, the executive budget document, the variance report, performance indicators, and other budget information. We do not agree with much of the consultants' illustrations, and in fact, consider most of their examples to be oversimplifications of not only the problems, but the solutions as well. However, we do agree that the basic issues are sound, and that some review and adjustment is warranted. It is suggested of course, that any specific changes proposed for these areas must be discussed and negotiated with the appropriate executive agencies prior to the development of implementing guidelines or legislation.

Finally, we would like to comment on the overall approach taken by the consultants in their fulfillment of the requirements of House Concurrent Resolution No. 202-90. As we understand it, HCR 202-90 required a ". . . report which recommends methods to strengthen the legislature's capacity to determine the appropriateness and productivity of state programs . . ." The most straightforward method being of course, the implementation and expansion of the provisions of Act 347/90, which sets up a legislative mechanism for fiscal and budget analysis, much like the Congressional Budget Office at the federal level. While acknowledging this as a need in the report, consultants Haldi and Schick do not give it the status of a recommendation, nor do they suggest the expansion of the capabilities of such an entity to include those responsibilities delegated to the executive branch and described in Chapter 4. The suggestion instead is that the executive branch should tailor <u>its</u> budget preparation and execution processes to accommodate legislative needs; a suggestion which is not totally without merit, but which inappropriately stretches the constitutional borders of legislative authority, placing many executive agencies into positions of conflict.

While we do not endorse any particular approach, we would suggest instead that the selection of any process should ultimately be guided by our obligation to maintain the constitutional and functional integrity of both our legislative and executive branches of government.

Sincerely,

Yuki Takemoto

YUKIO TAKEMOTO