Study of Executive Expenditure Controls

A Report to the Governor and the Legislature of the State of Hawai'i

Report No. 91-15
March 1991

THE AUDITOR
STATE OF HAWAI'I

The Office of the Auditor

The missions of the Office of the Auditor are assigned by the Hawaii State Constitution (Article VII, Section 10). The primary mission is to conduct post audits of the transactions, accounts, programs, and performance of public agencies. A supplemental mission is to conduct such other investigations and prepare such additional reports as may be directed by the Legislature.

Under its assigned missions, the office conducts the following types of examinations:

1. *Financial audits* attest to the fairness of the financial statements of agencies. They examine the adequacy of the financial records and accounting and internal controls, and they determine the legality and propriety of expenditures.

2. *Management audits,* which are also referred to as *performance audits,* examine the effectiveness of programs or the efficiency of agencies or both. These audits are also called *program audits,* when they focus on whether programs are attaining the objectives and results expected of them, and *operations audits,* when they examine how well agencies are organized and managed and how efficiently they acquire and utilize resources.

3. *Sunset evaluations* evaluate new professional and occupational licensing programs to determine whether the programs should be terminated, continued, or modified. These evaluations are conducted in accordance with criteria established by statute.

4. *Sunrise analyses* are similar to sunset evaluations, but they apply to proposed rather than existing regulatory programs. Before a new professional and occupational licensing program can be enacted, the statutes require that the measure be analyzed by the Office of the Auditor as to its probable effects.

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7. *Procurement compliance audits* and other *procurement-related monitoring* assist the Legislature in overseeing government procurement practices.

8. *Fiscal accountability reports* analyze expenditures by the state Department of Education in various areas.

9. *Special studies* respond to requests from both houses of the Legislature. The studies usually address specific problems for which the Legislature is seeking solutions.

Hawaii's laws provide the Auditor with broad powers to examine all books, records, files, papers, and documents and all financial affairs of every agency. The Auditor also has the authority to summon persons to produce records and to question persons under oath. However, the Office of the Auditor exercises no control function, and its authority is limited to reviewing, evaluating, and reporting on its findings and recommendations to the Legislature and the Governor.

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OVERVIEW

THE AUDITOR
STATE OF HAWAII

Study of Executive Expenditure Controls

Summary

Each fiscal year, the current administration withholds from its departments a portion of the moneys appropriated by the Legislature. Although state law allows the executive branch to spend less than the Legislature appropriates, the Legislature became concerned with the effects of this practice and the possibility that its own programs were the first to be restricted.

The administration's general rationale has been that funds are held back to cover unexpected downturns and to improve the efficiency of government operations. The current administration, however, has followed the same practice year after year, even when revenues have exceeded estimates, and it has done so without sufficient explanation for the specific amounts withheld.

The effectiveness of forced savings at the beginning of the year is questionable because restrictions are often restored anyway--usually in the fourth quarter. For example, in FY1989-90, the administration restored $22 million out of the $28 million it restricted. The Department of Budget and Finance does not evaluate the effectiveness of its practices year-to-year.

We found that the administration's spending instructions to departments have not been timely. In the current fiscal year, departments were not informed of what they could spend until six weeks after the fiscal year started. Instructions for previous years have also been late. The delay, coupled with the quarterly allotment system, meant that departments were forced to amend their spending plans.

As to the Legislature's concern about its programs being restricted first, we found that departments responded differently to the directive to cut spending. Some applied the reductions--usually a percentage--to all programs alike. Others used a selective approach, targeting particular programs, cost categories, or organizational units. Departments differed in their treatment of programs initiated by the Legislature. Some departments reduced these along with their own programs. Others applied the reductions first to all new programs, which meant many programs initiated by the Legislature were restricted first.

Recommendations and Response

We recommended that the Department of Budget and Finance develop more specific and pointed rationales for its restrictions, be more timely in its directives, and also monitor the effect of its practices to determine if reductions are fulfilling the desired purpose. We also recommended that B&F report routinely to the Legislature on the magnitude of the restrictions, the amounts lapsed, and the impact of the restrictions--including their impact on legislatively-initiated programs.

In its response, B&F defended its practices. It maintained that departments are given adequate notice of the restrictions and the rationale for them through the governor's cabinet meetings. It also maintained that the recommendations on monitoring and reporting were not based on any evidence that it was remiss in its operations.

Background

Historically, the separation of powers between the executive and legislative branches has involved some contention over fiscal policy and its implementation. With technology and the increasing complexity of society, the national trend has been for the executive branch to dominate both the budget preparation and execution processes. The authority and practice of the Hawaii state administration to decide what the level of expenditures should be despite what the Legislature has decided to appropriate reflects the long history of intermittent conflict in executive-legislative fiscal relationships.

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Submitted by

THE AUDITOR
STATE OF HAWAII

Report No. 91-15
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Foreword

The 1990 Supplemental Appropriations Act requested the auditor to study the practice by the executive branch of routinely withholding portions of the appropriations made by the Legislature. The Legislature's dissatisfaction with these restrictions on spending was heightened by the perception that the programs it initiates are the first to be kept from implementation. This report was prepared in response to this concern.

We wish to acknowledge the cooperation and assistance extended to us by the Department of Budget and Finance and by all the other departments that we contacted for information.

Newton Sue
Acting Auditor
State of Hawaii

March 1991

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Chapter 1

Introduction and Background

The Legislature's most important source of power and authority is its control over appropriations. In the last two decades, however, legislators have perceived a gradual loss of that control to the executive branch. Of particular concern has been the practice of the executive branch not to spend all that the Legislature appropriates. Legislative dissatisfaction has been fueled by the perception that the first appropriations to be withheld are those that the Legislature adds to the executive budget request. For its part, the executive branch maintains that delaying spending or withholding some of the appropriations encourages prudent fiscal management and more efficient operations.

To obtain a clearer picture of the situation, the Legislature requested the auditor to study the withholding practices used by the executive branch to spend less than what is appropriated. These practices have been labeled "efficiency reserves," "restrictions," (terms often used interchangeably) and "turnover savings."

Efficiency reserves (or "efficiency savings") usually refers to the practice of holding back from departments some of what they were appropriated, ostensibly to foster efficient management. The term *restrictions* includes efficiency reserves as well as funds withheld for contingencies. *Turnover savings* result from unfilled positions. Savings may accrue before a new employee is hired or when a new employee is paid less than the previous employee.

Through Section 260B of the General Appropriations Act of 1989, as amended by the Supplemental Appropriations Act of 1990, the Legislature requested that our study include the following:

- An assessment of the rationale underlying the various withholding processes;
- A review of the withholding processes, from planning to execution;
- A review of the actions taken by the departments in response to the directives to curtail spending; and
- An assessment of the effectiveness of the withholding processes in achieving intended goals.

The auditor's findings and recommendations are to be conveyed to the Regular Session of 1991. This report is in response to that request.

Objectives of the Study

1. Identify and describe the kinds of executive restrictions, their size, the rationale provided, and the fiscal context in which they have occurred.

2. Assess the administration of these restrictions by the Department of Budget and Finance (B&F) and the expending departments.

3. If appropriate, describe the alternatives available to the Legislature.

Scope and Methodology

The study focused on the Department of Budget and Finance but examined withholding practices in all the executive departments. We gathered information on their budget execution processes, on the appropriations withheld and the programs reduced in scope because of B&F directives, and on their perceptions of the effectiveness of the withholding mechanisms. Fiscal and administrative officials were interviewed. The University of Hawaii and the Department of Education have been granted some flexibility over their internal management. We included them in this study to determine how they reacted to restrictions and fared throughout the budget execution process.

Data were collected for the 1987-89 biennium and, to the extent possible, for the 1989-90 and 1990-91 fiscal years. We did not test the reliability or validity of the data received from the executive branch. The study was conducted between July and December 1990 in accordance with generally accepted government auditing standards except as noted above.

Historical Context

Legislative-executive conflict over the power of the purse is centuries old. Representative assemblies emerging in Europe in the 13th Century eventually became legislative bodies that could withhold consent to royal expenditures. The 19th Century saw the dominance of legislatures and parliaments. But in the 20th Century, as society became more complex and technological, the dominance of executive bodies was restored.[1]

Central to the return of executive dominance in the United States was the executive budget movement. Beginning in the first quarter of this century, the movement sought to bring order to fragmented budgeting and spending practices in which agencies submitted separate requests at differing times and then spent these without central control or supervision.[2]

The executive budget movement centralized the preparation and execution of the budget. Centralization has become so complete that, in all 50 states, agency requests are now submitted to the governors by late summer or early fall. And in 49 states, specific provisions have been made for the governors' budgets to be sent to the legislatures by a specific time, usually in January and February of the session that will adopt a budget.

The frequency of the legislative sessions and the time spanned by each appropriations act affect the degree of executive dominance. The less frequently a legislature meets, and the longer the time spanned by the appropriations acts, the greater the executive dominance. In 29 states, legislative sessions and appropriations cycles run on annual timetables; in 12 states, including Hawaii, legislative sessions are annual but budgets are enacted for biennial periods. And in nine states, both the legislative sessions and the appropriations are biennial.[3]

A similar shift has occurred in favor of the executive branch in the *expenditure* of funds authorized by legislatures. During the Great Depression of the 1930s, state governments found that it was not in their best interests to spend state funds as legislatures authorized. In times of uncertainty, there was a compelling need for government to spend only as revenues were actually received. Legislatures authorized governors to withhold expenditures to below the authorized levels, to transfer and allot funds in ways other than originally legislated, and to control the overall execution of the appropriations. Governors became controllers, assisted by larger, centralized budget staffs responsible for routine administrative controls over expenditures.[4]

Executive Controls in Hawaii

In Hawaii, the principle of executive dominance is of long standing. When Hawaii became a territory of the United States in 1900, the appointed governor was responsible for preparing a budget for submission to the elected Territorial Legislature. With statehood, the executive budget system was continued. The 1950 State Constitution also required the establishment of a system of expenditure controls. Article VII, Section 5, currently reads:

> Provision for the control of the rate of expenditures of appropriated state moneys, and for the reduction of such expenditures under prescribed conditions, shall be made by law. No public money shall be expended except pursuant to appropriations made by law. General fund expenditures for any fiscal year shall not exceed the State's current general fund revenues and unencumbered cash balances, except when the governor publicly declares the public health, safety or welfare is threatened as provided by law.

The allotment system

The system of expenditure controls that the Legislature enacted, called the *allotment system,* is spelled out in Sections 37-31 to 37-42, HRS. The essence of the allotment system is the division of the fiscal year into four quarters and the requirement that no appropriations are made available to a department until the director of finance approves its expenditure plan. One provision (Section 37-36) permits the director of finance to modify the allotment. Another, (Section 37-37) requires the director to reduce any allotment when the director determines "that the probable receipts from taxes or any other sources for any appropriation will be less than was anticipated . . . provided that no reduction reduces any allotted amount below the amount required to meet valid obligations or commitments previously incurred against the allotted funds."[5]

The Legislature's intent is that its appropriations shall be the maximum amount authorized and that the governor and the director of finance shall be granted power over the allotment system. Under the system, the director of finance is to effect savings by "careful supervision throughout each appropriation period" and by promotion of "more economic and efficient management of state departments and establishments."[6] In reviewing agency spending plans, the director of finance must consider the needs of each department, the terms and purposes of the appropriation, the progress of revenue collections, the condition of the treasury, and the probable receipts and cash requirements for the ensuing quarter.

Section 37-74, HRS, also requires that the Department of Budget and Finance (B&F) review the operations plan of each department for consistency with the governor's policy decisions and the Legislature's appropriations and for "proper planning and efficient management methods." The statute requires B&F to modify or withhold the planned expenditures at any time during the appropriation period if (1) it finds that the expenditures are greater than those necessary to carry out the programs at the level authorized by the governor and the Legislature or (2) if state receipts and surpluses will be insufficient to meet the authorized expenditure levels.

1978 constitutional amendments

The 1978 Constitutional Convention added, and the voters ratified, several important amendments. First, the governor may spend more general fund revenues than are collected upon publicly declaring that the public health, safety or welfare is threatened. Second, excess general revenues are to be returned to the taxpayers, with the amount returned to be set by the Legislature. (An "excess" occurs when the state general fund balance for any two successive fiscal years exceeds five percent of the general fund revenues for those two fiscal years.) Third, a council on revenues is authorized to prepare revenue estimates that both the governor and the Legislature must consider. If either branch exceeds the estimates in carrying out its respective functions, this fact must be made public, along with the reasons.

Administration's Expenditure Reductions Process

The executive branch follows an expenditure process that is similar from year to year. After signing the appropriations act, the governor, with the assistance of B&F, issues a memo entitled "Budget Execution Policies and Guidelines," which instructs departments on the forms to be filled out. At the same time or subsequently, the departments also receive a ceiling on what they may expend in the coming fiscal year.

The departments submit their spending plans for the entire year and for the first quarter. Later, at designated times, they submit plans for subsequent quarters. Before funds are released, the director of finance must approve the annual and quarterly spending plans. (The university and the DOE are exempt from the requirement that the director must approve the spending plans.)

Chapter 2

Spending What Is Appropriated

Inherent in the separation of powers between the legislative and executive branches of government is some contention over fiscal policy and the implementation of that policy. One area of contention is the appropriations process--deciding how much to appropriate for various programs. Another is the expenditure process--deciding how much to spend of what was appropriated. This chapter analyzes the rationale for the practices of the executive branch and describes how departments respond to instructions to hold down spending.

Summary of Findings

1. The administration has the authority to require executive agencies to spend less than what they are appropriated. There is room, however, for improvement in the way in which that authority is exercised.

    a. The Department of Budget and Finance has not explained how it derived the restrictions.

    b. The department's budget instructions entailing restrictions have not been timely.

    c. Information on the magnitude of restrictions and their impact is not routinely reported to the Legislature.

2. Executive agencies differ in their treatment of legislatively-initiated appropriations.

Rationale for the Amounts Withheld Is Not Explicit

The current administration has consistently withheld funds ever since the first full year the budget came under its control. Although the administration is within its purview in restricting spending, its rationale for the amounts withheld has not been explicit. Instructions to the departments have varied from year to year without explanation for the changes.

Administration rationale

The administration has not explained why the restrictions are being imposed and how the amounts or percentages are set.

Maintaining that the State should not spend all the funds it is authorized to spend, the administration says that some of the revenues should be reserved for contingencies and downturns. The administration also believes that agencies can, and should, operate more efficiently and that imposing "efficiency savings" or "efficiency reserves" at the beginning of the fiscal year will encourage them to do so.

First set of instructions

In its first budget execution memo of June 1987, the current administration set its course. It withheld three percent of department funds and required each department to identify two major areas for "purposeful accomplishment, innovation, or increased productivity" over the administration's term.[1] The memo expressed the governor's concern that the most recent revenue projections of the Council on Revenues had not been as optimistic as the appropriations act warranted. "We are obligated and duty-bound," the governor wrote, "to promote the efficient management of our respective programs and to insure the appropriate utilization of public funds."[2]

In his memorandum, the governor maintained that the Constitution and the statutes did not permit State finances to show a deficit in any fiscal year over the six-year planning period. This meant that, starting with the 1987-89 biennium, no deficit could be permitted through FY1992-93. Compliance, according to the governor, would be extremely difficult: "Past fluctuations in the State's financial condition have made compliance with the latter provision [that is, no deficit] an unpredictable and almost impossible task, for wholesale emergency budget adjustments may not be applied to at least 30-35 percent of the State's expenditures." These expenditures were the fixed costs, or the "first charges" on the State, consisting of such items as debt service, employee benefit payments, and grants to counties. Thus, maintained the governor, "our actions on this budget cannot be evaluated on a year-by-year basis but must be seen as only one part of a longer-term fiscal plan."

The budget instructions would have been more helpful had they contained the analyses leading to the restrictions. The instructions did not explain fully the administration's view of the state fiscal picture--when the ups and downs would come over the short and long term, and in what sectors of the economy. They did not explain how the administration had arrived at the specific percentage restrictions being imposed or what factors it had weighed. The spending instructions would have benefited from some numbers--for example, how much was required to cover fixed costs or what levels of usage might be expected, based on the most current estimates, in such entitlement programs as Medicaid.

Subsequent execution instructions

Budget execution instructions in subsequent years gave even less of the analysis underlying the restrictions and continued in the same cautious vein despite an increasing surplus. The administration warned departments not to spend everything that the Legislature authorized, but did not share its forecasts for downturns. It did not report on the magnitude and the effects of any prior year's restrictions, as we discuss later in this chapter.

In each of the following three years, the governor imposed spending restrictions even while revenue collections exceeded projections. Each year the State's surplus grew and each year the Legislature invoked the constitutional provision for a taxpayers' refund. For FY1986-87, the administration reported a surplus of $243.5 million in the general fund, an increase of more than $100 million during that year.[3] The 1988 Legislature authorized a tax credit of $1 to each resident taxpayer.[4] For FY1987-88, the surplus was $470.6 million[5] and the 1989 Legislature returned $125 per taxpayer.[6] For FY1988-89, the surplus was $749.2 million,[7] and the 1990 Legislature returned $60 to each taxpayer.[8]

The departments found it difficult to understand why they were not being allowed to spend more of what was appropriated, and the administration's subsequent instructions did not sufficiently explain. Not all of the funds that the administration restricted could be held for unforeseen circumstances. What is unspent will lapse back into the general fund, adding to the surplus, and at least some of that surplus must be returned to taxpayers.

Various levels of restrictions

In the past four years, the administration has imposed differing types and levels of restrictions but has not explained the reasoning behind them nor systematically assessed their impact on the departments. A portion of the restricted amounts are restored to departments by the end of the year and the remainder lapsed to the general fund. Table 2.1 summarizes this information for all departments for FY1987-88 through FY1989-90. Breakdowns by department are provided in Appendixes A, B, and C.

For FY1987-88, the governor permitted full funding for repair and maintenance of schools, libraries, hospitals, and other physical facilities. All departments were also required to set aside one percent in efficiency savings and another two percent in contingency reserves (except for the DOE, which was to set aside one percent in reserves). This meant that expenditure ceilings for departments were set at their appropriation levels less three percent. See Appendix A for the ceilings by department.

TABLE 2.1
Amounts Restricted, Restored, and Lapsed for All Departments FY1987-88 Through FY1989-90

	Restricted	Restored	Lapsed
FY1987-88	$33,718,524	$16,729,010	$16,989,514
FY1988-89	14,033,003	(6,558,135)	20,591,138
FY1989-90	28,652,915	22,140,562	6,512,353

Source: Letter to Senator Mamoru Yamasaki, Chair, Committee on Ways and Means, from Yukio Takemoto, Director of Finance, February 13, 1990.

The next year, FY1988-89, the governor required all departments to set aside one percent as efficiency savings but not the additional two percent in reserves. The instructions did not explain the change in approach from the previous year--whether there was no longer a pressing need to keep the reserves or whether the prior year's efficiency savings had made departments as productive as they should be. Appendix B displays the departmental reductions.

For the following two fiscal years, 1989-90 and 1990-91, the budget execution guidelines did not restrict a percentage across the board. The memos simply informed the departments of the governor's intention to set aside efficiency reserves. A subsequent memorandum informed departments of their spending ceilings (allocations). The memorandum did not communicate to the departments how the rationale was developed. We learned from B&F that to derive these ceilings the administration evaluated the fixed charges in each department's budget, the governor's priorities for his programs, and the budget items that may have received more than necessary. An example of the latter category is debt service--had the State been able to sell bonds at rates more favorable than budgeted, then B&F's budget could be reduced proportionately more than that of another department.

For FY1989-90, the spending ceilings were to consist of "adjusted authorizations" from the appropriations act. Collective bargaining appropriations were to be funded at 90 percent, purchase-of-service authorizations at 95 percent, and special repairs and maintenance, grants-in-aid, and subsidies at 100 percent. (The Department of Education was funded at 90 percent of its collective bargaining appropriation and 99 percent of its purchase of services budget.) The administration restricted an additional $16 million in general funds because that much more in federal impact aid funds had come to the State and could be substituted for general revenues. See Appendix C for the magnitude of the reserves for each department for that year.

For the current fiscal year, FY1990-91, the allocations consisted of adjusted authorizations from the appropriations acts and 90 percent of the authorizations for collective bargaining. Purchases-of-service contracts were to receive the full amounts authorized, as were the other programs funded at 100 percent the previous year. DOE was again exempted from the administration's restrictions except for ten percent of the collective bargaining increases and other salary adjustments.

Departments Differ in Their Response to Restrictions

We found that when faced with restrictions, the departments responded in different ways. In FY1990-91, administrative restrictions ranged from about one to five percent of a department's allocations. Of the 18 executive departments, 9 imposed, or considered imposing, their own additional restrictions, and these also varied. The DOE imposed its own 5 percent restriction after the administration gave it 100 percent of its authorization (except for salary adjustments). Most departments applied their restrictions across the board, but some used selective approaches.

Table 2.2 summarizes some results from our survey showing the percent that the administration restricted, any additional restrictions imposed by the departments, and the manner of restriction.

To date, no department has exercised its right to appeal the restriction. Department heads proceed as best they can, and if a shortfall persists into the fourth quarter, they may request release of the reserves. This is done through a letter to B&F, usually in March or April. In prior years, most of the restrictions imposed at the beginning of the fiscal year were in fact restored.

Departmental perceptions

Departmental personnel acknowledged some difficulty in understanding the administration's rationale for imposing reserves in light of what appeared to be sufficient revenues to cover what had been appropriated. Some departments believed they had already pared, or had been pared, "down to the bone." Turnover savings had already been taken. "Turnover savings" occur when positions are vacated and not filled immediately, or when new positions are authorized and the normal recruitment and selection process takes a while. In the budget-building process the departments are expected to remove turnover savings before submitting their requests for the next budget to B&F.

TABLE 2.2
Departmental Restrictions and Actions Taken
FY1990-91

	Percent Restricted		How Restriction Applied	
	By B&F	By Department	Across the Board	Selectively
Accounting & General Services	3			x
Agriculture	3		x	
Attorney General	4			x
Budget & Finance	5	$250,000*	x	
Business & Economic Development	3	2**		x
Commerce & Consumer Affairs	1	4	x	
Defense	2			x
Education	-	5+		x
Hawaiian Home Lands	1		x	
Health	4		x	
Human Services	-*		x	
Labor & Industrial Realtions	3		x	
Land & Natural Resources	4	1	x	
Personnel Services	1	3	x	
Public Safety	3	2	x	
Taxation	3	3.5	x	
Transportation	1-3	10	x	
University of Hawaii	1		x	

Source: Interviews with fiscal and administrative staff of each department, Fall 1990.

* The restriction was imposed in dollar amount, not percent.
** Under consideration.
\+ Restriction placed on state and district offices.

Some departmental personnel believed they were already efficient in their operations. Others did not understand the size of the percentage assigned to them or the continuation of withholding each year. They argued that if the purpose of the initial restriction is to set aside funds for contingencies, then, from the beginning, a contingency fund should be set aside for that specific purpose. Others argued that if the purpose of restriction is to promote efficiency, then B&F ought to evaluate the programs and set priorities. B&F countered that the departments are in the best position to know where savings can be effected. B&F does not identify which programs in each department ought to contribute to the reserves.

A few departments saw no serious problems with the instructions to restrict. These tended to have either (1) budgets that do not rely heavily on general funds or (2) other ways to accommodate the reductions. Departments with substantial special or federal funds (such as the Department of Transportation and the Department of Defense) can use them to make up cuts in their general funds. Other department heads have been able over the years to have the divisions take turns absorbing reductions. As each year progresses, the divisions can petition for restoration on the basis of need. The process is usually marked by openness--division budgets are revealed and the reasons for restrictions made clear.

Across-the-board or selective restrictions

Of the 18 departments, 13 applied their restrictions across the board by organizational unit, leaving the programmatic impact up to the divisions to decide, as shown previously in Table 2.2. For example, in the Department of Human Services, the divisions received their prorated restrictions and most started by "freezing," or not filling, new positions and delaying equipment purchases to the fourth quarter.

The five departments that applied the restrictions selectively used different approaches. For example, the Department of Business and Economic Development asked each division to evaluate its programs. Sometimes the director restricted an entire program, and the division would have to justify why the program should not be restricted. The Department of Accounting and General Services has applied restrictions selectively because its divisions vary greatly in size. The larger divisions have had to contribute a larger percentage so that the department can meet its requirement. All divisions were allowed to appeal directly to the comptroller.

The DOE was not required by B&F to restrict funds for the current year. However, DOE decided to reserve five percent of the "other operating costs" and equipment budgets, commonly called "B" and "C" funds, from the district and state offices. It also restricted some

"A," or personnel, funds, especially funds for hourly and part-time employees. The DOE acknowledges that in restricting funds, it is setting up a contingency fund for itself, but justifies this based on its prior experience. In FY1989-90, for example, it had a shortfall in payroll funds in the fourth quarter. When B&F did not make up the shortfall from previously restricted funds, DOE had to use its own contingency funds.

Like other departments that are able to substitute federal and special funds for general funds, DOE was able to meet its restriction requirements. For example, in FY1987-88, when a one-percent restriction amounting to $3.9 million was imposed, DOE generated $3 million of this by eliminating the Education Superfund of $2 million and by substituting $1 million from the school lunch special fund.[9] The department's ability to make the substitution suggests that the special fund was over-budgeted and over-appropriated.

Instructions Are Not Timely

In the current fiscal year, the lateness of the administration's expenditure instructions contributed to the difficulty that the departments had in accommodating and accepting the requirement to restrict funds. Some departments had already begun implementing their expenditure plans. The administration has issued its instructions later and later in each of the past four years. In the first year, the instructions were issued on June 19; in the second, on July 8; in the third, on July 17; and most recently, not until August 20, 1990.

For the last three of these years, the fiscal year had started before the departments were told how much they had to restrict. The problem was especially acute in the current fiscal year, when almost two months into the year, the departments discovered they had to restrict as much as five percent of their appropriations.

Magnitude of Restrictions Is Not Routinely Reported to the Legislature

The Department of Budget and Finance does not routinely inform the Legislature of the magnitude of the amounts restricted and subsequently restored. To get this information, the Legislature must make a specific request. The State's official accounting report, the *Comprehensive Annual Financial Report* prepared by the Department of Accounting and General Services, does not contain information on what was held initially in reserves and what was released eventually to the departments. It only reports on the total amount lapsed. The Legislature therefore has no direct access to audited information on initial and final restrictions.

As shown previously in Table 2.1, B&F initially held back $33.7 million in FY1987-88, restored half of that, and then lapsed the other half. In FY1988-89, B&F reported on initial restriction of $14 million, but lapsed a total of $20.6 million by the end of the year. This was due to unbudgeted federal aid received by the DOE. Had these federal funds not come to the state, the total lapsed by the end of the year would have been about $8 million. The following year, B&F initially restricted $28.6 million and by the end of the year restored $22.1 million. The net restriction of $6.5 million was lapsed.

Amounts lapsed to general fund

B&F does not report on the amounts lapsed due to restrictions as against all moneys lapsed. With this information, the Legislature could ascertain whether the levels of appropriations are too high, whether departments have padded their budget requests in anticipation of executive restrictions, and whether departmental complaints about the restrictions are valid. Information on the amounts lapsed could bring some perspective to questions about the size of restrictions imposed by the administration.

In the three fiscal years between 1987 and 1990, the amounts lapsed as the result of restrictions were only a small portion of all general funds lapsed. In FY1989-90, for example, the $6.5 million lapsed from restrictions was only about 17 percent of the $39 million lapsed from all sources. Figure 2.1 displays this information for the three fiscal years.

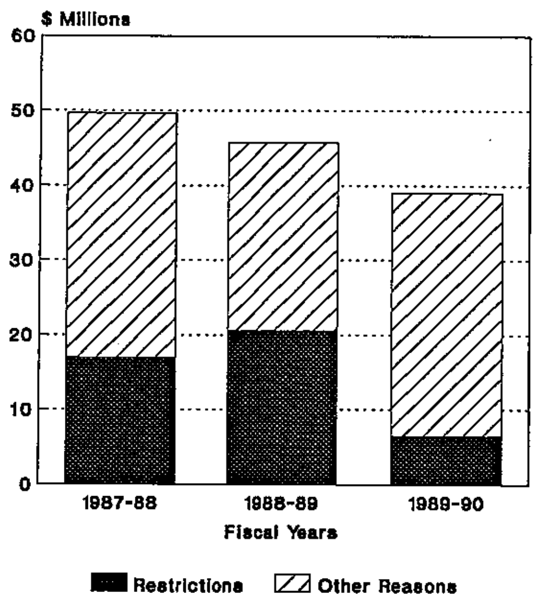
In some departments, the amounts lapsed from restrictions were only a small proportion of the total amount lapsed. For example, in FY1989-90, the Department of Labor lapsed a total of $1,461,900, of which $254,078, or 17 percent, was from restrictions. The Department of Human Services lapsed a total of $8,500,582, of which $1,024,647, or 12 percent, was lapsed from restrictions. For the same period, the Department of Education lapsed a total of $17,266,640, of which $129,116, or .07 percent, was from restrictions. (For a breakdown by department for each of the three fiscal years, see Appendix D.)

Impact of restrictions

Unless the Legislature asks specifically for the information, it will not know how departments handled the restrictions, what programs they restricted, and the net effect on their operations. In FY1988-89, for example, DOE's one percent restriction amounted to $4.5 million. Table 2.3 displays how DOE distributed these restrictions. Amounts withheld from programs ranged from $7,000 appropriated for an air conditioner to $1.2 million appropriated for equipment and supplies. Whole programs, projects, and program expansions were

Figure 2.1

Moneys Lapsed to the General Fund
Due to Restrictions and Other Reasons
FY1987-88 through FY1989-90



Source: Letter to Senator Mamoru Yamasaki from Yukio Takemoto, February 13, 1990; letter to Alan Taniguchi fro Yukio Takemoto, November 29, 1990.

not funded. The three percent reduction in supply and equipment funds (which includes textbooks) of $1.2 million, must have had some impact on schools' purchases, but this was not routinely reported to the Legislature.

The DOE's ability to accommodate general fund restrictions with special funds and to generate savings from lower fringe benefit rates on federal and special funds would have alerted the Legislature to raise questions about DOE's budget submissions. It would be helpful if the Legislature were routinely informed of the impact of the restrictions on programs and on program performance.

TABLE 2.3
General Fund Programs Restricted, Department of Education, FY1988-89

	Restricted
1. Equipment funds:	
a. ETV replacement	$ 173,220
b. Science equipment	215,000
c. Music equipment	215,000
d. Vocational education equipment	100,000
2. Real Life Skills Project	300,000
3. Training funds:	
a. Teacher training	157,796
b. EO training	8,220
c. Classified training	25,773
4. Evaluation	100,000
5. Education Superfund	287,190
6. New appropriations for Fiscal Year:	
a. Air conditioner for Hilo High School computer room	7,000
b. Distance Learning	482,415
c. Space Seminar	70,000
d. Vocational Industrial Clubs of America	20,000
e. Speech coaches' differential	30,000
f. Heeia year-round school study	15,000
g. Films on World War II experiences	50,600
h. Conference conducted by the Elementary School Center-Hawaii	10,000
i. Host Teacher	28,515
j. Conflict Management Training	6,000
k. Paid professional leave for school level administators	10,000
l. Military liaison services for Windward and Leeward	18,582
m. Night security services	300,000
7. 90-day manpower freeze on state and district positions	145,460
8. Three percent reduction of B & C funds	1,214,073
9. Savings for lower fringe benefit rates on Impact Aid and School Lunch funds	518,797
TOTAL	$ 4,508,641

Source: Memorandum to Alan Taniguchi, Office of the Auditor, from Don Kanagawa, Department of Education, October 12, 1990, p. 4.

Departments Differ In Treatment of Legislatively Initiated Programs

The Legislature has been concerned that the projects and programs it initiates and includes in the appropriations acts are the first to be restricted by the administration. In our survey, departments reported that they treat these appropriations no differently from their other programs, whether they apply their restrictions across the board or selectively among divisions. They acknowledge, however, that when they "look for money," the least painful places to restrict are the programs that have not yet been implemented--which would include the Legislature's initiatives. Some departments that apply across-the-board restrictions admit that the targeting of legislative programs varies from administrator to administrator. Some administrators reportedly forego their own initiatives to implement legislative programs.

The university's approach, for example, may result in the saving of some of the legislative programs. Its budget office first identifies the one-time appropriations, such as those for studies, repair and maintenance, and special equipment, before giving administrators the reserve amounts they must come up with. Taking this group of items "off the top" may preserve items that the Legislature initiated.

At the other extreme, in the DOE the programs initiated by the Legislature were the ones affected by the mandatory restrictions. In Table 2.3, many of the items restricted, whether whole projects or parts of programs, were included in the budget at the initiative of the Legislature. Unless the Legislature is informed, it would not know whether its initiatives were restricted disproportionately.

Some attempts, including legal suit, have been made to resolve the issue. In 1976, the Legal Aid Society filed suit on behalf of clients over the withholding of funds for a legislatively-initiated program. The court upheld the administration's authority to make the cuts.

The Legislature could better carry out its fiscal policy responsibilities if it routinely receives information on the status of legislatively-initiated budget items along with the administration's own restrictions, the rationale underlying the actions, and the impact of these actions of the departments.

Recommendations

The Department of Budget and Finance could make improvements in the expenditure process by doing the following:

1. Making its rationale for restrictions more explicit and providing this information to the departments.

2. Issuing more timely instructions to the executive departments on restrictions it intends to impose.

3. Monitoring more closely the impact of the restrictions on departments to determine if they are accomplishing the intended purposes.

4. Reporting routinely to the Legislature on the magnitude of the restrictions, the amounts lapsed, and their impact, including the impact on legislatively-initiated programs.

Notes

Chapter 1

1. Charles R. Adrian, *State and Local Governments*, McGraw-Hill, New York, 1976, in Newton N.S. Sue, *Hawaii Constitutional Convention Studies 1978, Article VI: Taxation and Finance*, Legislative Auditor, Honolulu, 1978, p. 3.

2. Allen Schick, *Budget Innovation in the States*, Brookings Institution, Washington, D.C., 1971, in Newton N.S. Sue, *Hawaii Constitutional Convention Studies 1978*, p. 4.

3. Advisory Commission on Intergovernmental Relations, *Significant Features of Fiscal Federalism, Vol. I, Budget Processes and Tax Systems*, 1990, pp. 4-5.

4. Allen Schick, "Review and Evaluation Can Focus Light On Legislative Reform," in *Yearbook of the National Conference of State Legislative Leaders*, Milwaukee, November 1971, in Newton N.S. Sue, *Hawaii Constitutional Convention Studies 1978*, p. 6.

5. In the case of the University of Hawaii and the Department of Education, the governor sets only the ceilings of the allotment. General fund appropriations for the public health facilities may be made available at any time in the fiscal year.

6. Section 37-31, HRS.

Chapter 2

1. Memorandum to All Department Heads from John Waihee, Memo No. 87-8, June 29, 1987, p. 2.

2. Ibid., p. 1.

3. Hawaii, *The Executive Budget Supplemental (Budget Period: 1987-89)*, Vol. I, December 1987, p. 81.

4. Act 185, SLH 1988.

5. Hawaii, *The Multi-Year Program and Financial Plan and Executive Budget For the Period 1989-1995 (Budget Period: 1989-91)*, Vol. I, December 1988, p. 73.

6. Act 323, SLH 1989.

7. Hawaii, *The Executive Budget Supplemental (Budget Period: 1989-91)*, Vol. I, December 1989, p. 75.

8. Act 186, SLH 1990.

9. Memorandum to Alan Taniguchi, Office of the Auditor, from Don Kanagawa, Department of Education, October 12, 1990, p. 3.

Response of the Affected Agency

Comments on Agency Response

A preliminary draft of this report was transmitted on February 15, 1991, to the Department of Budget and Finance. A copy of the transmittal letter is included as Attachment 1. The response from the Department of Budget and Finance is included as Attachment 2.

The Department of Budget and Finance generally defended its budget practices.

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

February 15, 1991

The Honorable Yukio Takemoto, Director
Department of Budget and Finance
State Capitol, Rm. 411
Honolulu, HI 96813

Dear Mr. Takemoto:

Enclosed are three copies, numbers 6 to 8 of our draft report, *Study of Executive Expenditure Controls.* We ask that you telephone us by February 20, 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 February 27, 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
HOUSING FINANCE AND DEVELOPMENT CORPORATION
OFFICE OF THE PUBLIC DEFENDER
PUBLIC UTILITIES COMMISSION

STATE OF HAWAII
DEPARTMENT OF BUDGET AND FINANCE
STATE CAPITOL
P.O. BOX 150
HONOLULU, HAWAII 96810-0150

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

March 8, 1991

RECEIVED
MAR 11 8 21 AM '91
OFC. OF THE AUDITOR
STATE OF HAWAII

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

Dear Mr. Sue:

We would like to offer the following comments in response to your recommendations in the draft report, Study of Executive Expenditure Controls.

The Department of Budget and Finance could make improvements in the expenditure process by making its rationale for restrictions more explicit and providing this information to the departments.

The Department of Budget and Finance could make improvements in the expenditure process by issuing more timely instructions to the executive departments on restrictions it intends to impose.

Comments:

The report separates, and indeed deletes, the Governor's participation in this process, and attributes the process and its parameters solely to the staff of the Department of Budget and Finance. The omission is significant because it deletes the primary element of organizational policymaking, whether it be in the form of a chief executive or legislative leadership, as originator of an organization's direction. Elimination of this causal factor erroneously focuses the study on effectuating processes, which the budget execution instructions represent. Thus, it is not unusual for evaluators such as yourself to assume that no rationale exists in the execution policies; for at that point, the next phase of implementing procedures are being expressed.

Policies are often expressed during prior cabinet meetings, with general implementing instructions following in the form of budget execution policies. At that point, departments have already been made aware of the direction of the administration. As noted by the Audit itself, "The Executive branch follows an expenditure process that is similar from year to year . . . (with) 'Budget Execution Policies and Guidelines' (that) instruct(s) departments on the forms to be filled out." Thus, despite its apparent untimeliness, departments are already aware of adjustments which must be made, and are already in the process of reviewing their alternatives.

The Department of Budget and Finance could make improvements in the expenditure process by monitoring more closely the impact of the restrictions on departments to determine if they are accomplishing the intended purposes.

The Department of Budget and Finance could make improvements in the expenditure process by reporting routinely to the Legislature on the magnitude of the restrictions, the amounts lapsed, and their impact, including the impact on legislatively-initiated programs.

Comments:

It is our opinion that these two recommendations were not based on evidence that the B&F was remiss in its operations in these areas. Much of the "intended purposes" of the efficiency reserves were fiscal discipline procedurally applied in anticipation of possible economic fluctuations and fiscal caution in carrying out the intent of the Legislature, i.e., initially attempting to provide the same level of services with less dollars.

The administration takes little comfort in the Auditor's hindsight assurances that revenues have always been favorable (page 9). The executive branch is the only constitutionally-directed branch which must insure a balanced six-year budget plan for all branches of state government. Revenue projections before the fact are never guaranteed, and we therefore do not consider a posture of initial fiscal year caution to be irresponsible, or a refutation of legislative funding levels and priorities. As correctly noted by the Auditor, much of the efficiency reserves are reinstated to departments later in the year as revenues materialize (page 11). Further, everyone would agree that it would make no sense to exercise spending caution in the latter part of a fiscal year (in brinksmanship anticipation of an economic crisis) after most moneys have been expended. Unfortunately, the practicalities of timing require that fiscal caution be exercised in anticipation of, and not in reaction to, possible crises.

In conclusion, it is believed that to allay legitimate legislative concerns in this area, a more pertinent approach would have been to seek answers to the following question: What function or legislatively-funded program has not been satisfactorily or appropriately implemented, and can the problem be directly attributable to specific dollar amounts restricted by the Administration?

We hope our comments will be of some assistance in your evaluation of expenditure controls. Thank you for allowing us to participate.

Sincerely,

YUKIO TAKEMOTO

Amounts Restricted, Restored, and Lapsed FY1987-88

Department	Restricted	Restored	Lapsed
Agriculture	$ 329,834	$ 160,792	$ 169,042
Accounting & General Services	1,807,618	779,318	1,028,300
Attorney General	558,646	326,175	232,471
Business & Economic Development	1,601,668	364,257	1,237,411
Budget & Finance	1,665,458	333,101	1,332,357
Commerce & Consumer Affairs	318,619	106,261	212,358
Defense	1,625,641	750,000	875,641
Corrections	1,588,596	1,588,596	0
Education	4,098,017	3,934,886	163,131
Governor	292,811	38,151	254,660
Hawaiian Home Lands	0	0	
Human Services	2,977,421	2,299,927	677,494
Health	8,458,629	2,199,174	6,259,455
Labor & Industrial Relations	421,184	140,398	280,786
Land and Natural Resources	771,198	694,155	77,043
Lieutenant Governor	72,534	0	72,534
Personnel Services	121,300	55,716	65,584
Taxation	337,498	112,499	224,999
Transportation	10,848	0	10,848
University of Hawaii	6,661,004	2,845,604	3,815,400
TOTAL	$33,718,524	$16,729,010	$16,989,514

Source: Letter to Senator Mamoru Yamasaki, Chair, Committee on Ways and Means, from Yukio Takemoto, Director of Finance, February 13, 1990.

Amounts Restricted, Restored, and Lapsed FY1988-89

Department	Restricted	Restored	Lapsed
Agriculture	$ 45,016	$ 45,016	$ 0
Accounting & General Services	1,053,052	0	1,053,052
Attorney General	144,281	0	144,281
Business & Economic Development	461,300	224,000	237,300
Budget & Finance	738,642	0	738,642
Commerce & Consumer Affairs	120,182	0	120,182
Defense	1,553,561	0	1,553,561
Corrections	539,524	539,524	0
Education	4,674,911	(7,883,193)	12,558,104
Governor	125,584	0	125,584
Hawaiian Home Lands	10,596	0	10,596
Human Services	437,035	0	437,035
Health	1,318,834	0	1,318,834
Labor & Industrial Relations	62,271	0	62,271
Land and Natural Resources	208,905	208,905	0
Lieutenant Governor	37,419	0	37,419
Personnel Services	47,729	0	47,729
Taxation	49,639	0	49,639
Transportation	2,832	0	2,832
University of Hawaii	2,401,690	307,613	2,094,077
TOTAL	$14,033,033	$(6,558,135)	$20,591,138

Source: Letter to Senator Mamoru Yamasaki, Chair, Committee on Ways and Means, from Yukio Takemoto, Director of Finance, February 13, 1990.

Note: Net restriction for the Department of Education is a result of the release of unbudgeted federal impact aid funds.

APPENDIX C

Amounts Restricted, Restored, and Lapsed FY1989-90

Department	Restricted	Restored	Lapsed
Agriculture	$ 491,271	$ 336,271	$ 155,000
Accounting & General Services	2,304,180	1,806,286	497,894
Attorney General	937,581	937,581	0
Business & Economic Development	2,046,638	1,174,138	872,500
Budget & Finance	2,426,665	2,426,665	0
Commerce & Consumer Affairs	459,232	364,040	95,192
Defense	162,428	17,300	145,128
Corrections	2,114,115	2,108,527	5,588
Education	2,130,889	2,001,773	129,116
Governor	599,055	489,055	110,000
Hawaiian Home Lands	100,653	9,080	91,573
Human Services	3,918,214	2,893,567	1,024,647
Health	5,613,997	5,443,669	170,328
Labor & Industrial Relations	473,903	219,825	254,078
Land and Natural Resources	1,153,421	996,173	157,248
Lieutenant Governor	85,605	5,430	80,175
Personnel Services	180,686	180,686	0
Taxation	493,175	250,550	242,625
Transportation	29,711	5,718	23,993
University of Hawaii	2,931,496	474,228	2,457,268
TOTAL	$28,652,915	$22,140,562	$6,512,353

Source: Letter to Alan Taniguchi, Legislative Analyst, Office of the Auditor, from Yukio Takemoto, Director of Finance, November 29, 1990.

APPENDIX D
Moneys Lapsed to the General Fund from Restrictions and Other Sources, FY1987-88 through FY1989-90

Department	FY1987-88			FY1988-89			FY1989-90		
	Restrictions	Other Sources	Total Lapsed	Restrictions	Other Sources	Total Lapsed	Restrictions	Other Sources	Total Lapsed
Agriculture	169,042	27,458	196,500	0	49,294	49,294	155,000	107,686	262,686
Accounting and General Services	1,028,300	2,377,624	3,405,924	1,053,052	1,247,691	2,300,743	497,894	910,541	1,408,435
Attorney General	232,471	5,445	237,916	144,281	67,284	211,565	0	79,927	79,927
Business and Economic Development	1,237,411	1,035,228	2,272,639	237,300	3,307,533	3,544,833	872,500	839,255	1,711,755
Budget and Finance	1,332,357	3,076,669	4,409,026	738,642	6,775,629	7,514,271	0	1,183,907	1,183,907
Commerce and Consumer Affairs	212,358	207,003	419,361	120,182	64,374	184,556	95,192	111,607	206,799
Defense	875,641	239,940	1,115,581	1,553,561	68,636	1,622,197	145,128	773,551	918,679
Corrections	0	451,168	451,168	0	90,425	90,425	5,588	292,074	297,662
Education	163,131	15,353,237	15,516,368	12,558,104	111,102	12,669,206	129,116	17,137,524	17,266,640
Governor	254,660	245,543	500,203	125,584	290,385	415,969	110,000	883,304	993,304
Hawaiian Home Lands	0	0	0	10,596	162,084	172,680	91,573	40,970	132,543
Human Services	677,494	4,546,359	5,223,853	437,035	4,357,880	4,794,915	1,024,647	7,475,935	8,500,582
Health	6,259,455	3,680,554	9,940,009	1,318,834	4,763,918	6,082,752	170,328	692,149	862,477
Labor and Industrial Relations	280,786	36,094	316,880	62,271	1,235,266	1,297,537	254,078	1,207,822	1,461,900
Land and Natural Resources	77,043	200,175	277,218	0	37,898	37,898	157,248	55,223	212,471
Lt. Governor	72,534	177,534	250,068	37,419	238,504	275,923	80,175	223,809	303,984
Personnel Services	65,584	597,813	663,397	47,729	1,790,573	1,838,302	0	64,597	64,597
Taxation	224,999	11,058	236,057	49,639	27,999	77,638	242,625	73,160	315,785
Transportation	10,848	231,477	242,325	2,832	152,132	154,964	23,993	152,024	176,017
University of Hawaii	3,815,400	169,426	3,984,826	2,094,077	293,879	2,387,956	2,457,268	203,582	2,660,850
Total	$16,989,514	$32,669,805	$49,659,319	$20,591,138	$25,132,485	$45,723,623	$6,512,353	$32,508,647	$39,021,000

Sources: Letter to Senator Mamoru Yamasaki from Yukio Takemoto, February 13, 1990; letter to Alan Taniguchi from Yukio Takemoto, November 29, 1990.