Joint Legislative Audit and Review Commission

The Virginia General Assembly

Review of Virginia's Executive Budget Process

A Report in a Series
on the Executive Budget Process

REPORT OF THE
JOINT LEGISLATIVE
AUDIT AND REVIEW COMMISSION ON

Review of Virginia's Executive Budget Process

TO THE GOVERNOR AND
THE GENERAL ASSEMBLY OF VIRGINIA

SENATE DOCUMENT NO. 15

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Members of the Joint Legislative Audit and Review Commission

Preface

The Joint Legislative Audit and Review Commission (JLARC) was mandated by the 1990 Appropriation Act (amended and reenacted in the 1991 Session) to "review the Commonwealth's executive system of financial planning, execution and evaluation." This review is the third in a series of reports to address that mandate. The two previous reports — one on general fund revenue forecasting and one on a rainy day fund proposal — were presented to the 1991 Session.

This JLARC review found that, overall, the budget process in Virginia is sound. It has been shown to be responsive to the current budget problem. While this report does recommend improvements to the process, these recommendations should be seen in the context of a budget system that largely reflects and meets the needs of our executive and legislative institutions and a citizen legislature.

While the process is a sound one, it can be improved. Recommendations include making systematic program evaluations of agencies' base budget programs part of the process, clarifying legislative intent regarding the use of program budgeting, implementing incentives for agency directors to practice sound financial management, and improving nongeneral revenue fund estimates and reporting.

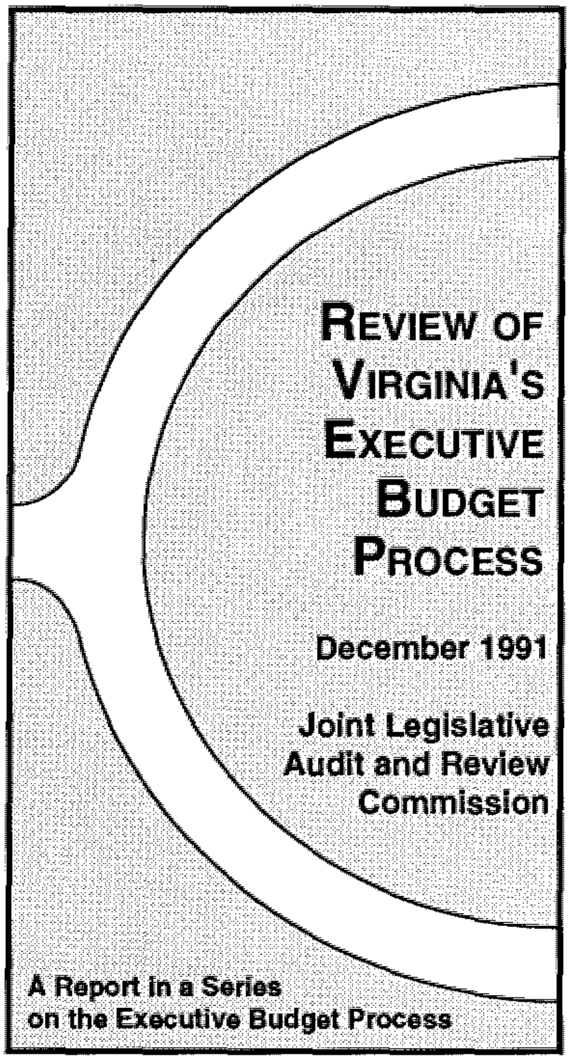
On December 16, 1991, the Chairman of JLARC announced that a comprehensive budget reform bill was prefiled to implement the recommendations from this study. Among the bill's provisions is a requirement that the Governor submit his budget to the General Assembly by December 20, rather than after the legislature convenes in January. This budget reform package, as well as other legislation resulting from this study, will be considered during the 1992 Session of the General Assembly. Copies of this proposed legislation are included in Appendix D.

Finally, the Secretary of Finance and the Director of the Department of Planning and Budget expressed general agreement with the findings and recommendations of this study. On behalf of JLARC staff, I would like to thank the Secretary of Finance and the Director and staff of the Department of Planning and Budget for their cooperation and assistance during the course of this study.

Philip A. Leone
Director

December 30, 1991

JLARC Report Summary



Overall, the executive budget process is a sound one. However, the process can be improved. For instance, partly because of the use of incremental rather than program budgeting, insufficient evaluation of programs in agency base budgets is being conducted by the executive branch. Estimating and reporting of nongeneral funds remains a problem, though first identified by JLARC in the 1980 report, *Federal Funds in Virginia*. In addition, more incentives for good financial management by agencies should be considered. The time the legislature has to make appropriation decisions needs to be increased. An earlier submission of the Governor's budget -- by December 20 -- would give the General Assembly almost an additional month for review. Finally, additional information could be provided by the executive branch that would assist legislative decisionmaking.

During this review, many State agencies commented on the improved capabilities and professionalism shown by Department of Planning and Budget (DPB) analysts over the past 10 years. Those same agencies also noted that further refinements in DPB's operations could enhance the budget process.

A brief explanation of these and other major findings is contained in this summary. Detailed explanations and specific recommendations are contained in the text of this report.

The executive budget process as defined in this study is the means used to develop, execute, and evaluate Virginia's operating budget. The General Assembly, recognizing the importance of systematically assessing the efficiency and effectiveness of the budget process, mandated JLARC's review in the 1990 Appropriation Act (amended and reenacted in the 1991 Act). This is the first comprehensive study of the executive operating budget process since the General Assembly legislated major changes to the process in the mid-1970s.

Virginia's Budget Process Has Evolved Over Time

Virginia's budget process has evolved substantially since the first executive budget was introduced to the General Assembly in 1920. As late as 1966, the State was still using a private consulting firm to review

State agencies' funding requests. The process was a manual one, completed with the aid of adding machines and typewriters. There was little thought given to integrating planning with budgeting because the budget process was a simple one, based on past funding.

As the complexity of Virginia's budget has grown, the budget process has evolved as well. During Governor Godwin's first term, a professional budget staff was hired. In the early and mid-1970s, a secretarial system was established to provide policy guidance. Later, legislative staffs were hired to improve legislative oversight of the process.

In 1975, the General Assembly adopted program budgeting as a way to integrate planning and budgeting. At the same time, the General Assembly established the Department of Planning and Budget (DPB) to develop and direct the new integrated process. Automation of the process followed, with the development of computerized budgeting and accounting systems.

Virginia's Use of Program Budgeting

The integrated budgeting process that the General Assembly adopted in 1975 was a comprehensive and rigorous program budgeting model. The executive branch fulfilled legislative intent and for the first two biennia made a sincere and concerted effort to use program budgeting in its model form. This level of program budgeting proved difficult to implement, however, and resulted in excessive paperwork that was often not used during budgetary decisionmaking.

Over time, some excessive requirements have been eased by the executive branch, generally with the acquiescence of the legislative branch. However, the *Code of Virginia* still reflects most of the initial, stringent requirements.

Legislative intent regarding program budgeting could be clarified by amending the *Code of Virginia* to delete some of its more stringent and unnecessary components, keeping those that are key to a sound program budgeting system. The following recommendation is made in this area:

- The General Assembly may wish to clarify legislative intent regarding executive budget development by amending the *Code of Virginia* to include only the following requirements of program budgeting: identification of common efforts and services; appropriation of funds according to programs; identification of service attainments or lack of attainments; and articulation of program justifications, including goals, objectives, and the authority for the program.

Consequences of Virginia's Approach to Budgeting

Program budgeting, as first implemented, was envisioned as a bottom-up process where agencies would identify and prioritize their program needs and submit them to the Governor. The Governor would weigh competing needs and determine the amount of funding each agency would receive. Over time, Virginia's process has evolved to be largely incremental — where an agency's previous budget serves as its base for the next year and special attention is normally focused on a relatively narrow range of increases and decreases.

There have been consequences to this incremental approach to budgeting. Agency budgets are no longer developed "bottom-up" — that is, based on program needs. In addition, little consideration has been given to rising program costs, including inflation. Executive budgetary attention has consisted primarily of financial assessments of agencies' base budgets. These have been routinely done, as have policy analyses and financial assessments of requests for new programs and services. However, program evaluation of the programs in base budgets has taken place sporadically. Recent budget reductions have required DPB and State agencies to examine opportunities for downsizing and cost savings based on the effectiveness of selected State programs. However, there is no guarantee this type of programmatic examination of agency base budgets will continue when revenues improve.

There are several recommendations to improve the evaluation of base budget programs made in this report:

- The Director of DPB should develop an appropriate methodology for programmatic examination of base budgets. Programs could be targeted for review in each biennial budget cycle, in consultation with the Governor's secretaries and House Appropriations and Senate Finance committees. Further, the Director should develop a training program on the methodology for DPB budget analysts.

- The Director of DPB should ensure that more of the evaluation section's effort is directed to program evaluations of existing State programs.

- The Director of DPB should assess ways that agency program information and evaluation resources can be used by the department to increase its program evaluation activities. In addition, line agencies should share internal program evaluations with DPB.

- The Director of DPB should proceed with plans to develop performance measures for some base budget programs on a pilot basis, and should ask for legislative input into decisions on the measures developed and their implementation.

Budgetary Responses to Revenue Declines Have Been Timely

No matter what type of budgeting is used, a good process will directly relate revenues to budgeted amounts. An examination of the executive branch's budgetary responses to the declining revenue forecasts for the 1990 and 1991 fiscal years shows that budgetary responses to these declines have been timely.

One way to improve the level of knowledge regarding forecasts would be to continue the interim forecast (a forecast in addition to the annual forecast to be produced in times of declining resources). The interim forecast was adopted by the 1991 General Assembly partly because of a JLARC recommendation in a previous report, *Revenue Forecasting in the Executive Branch: Process and Models.*

The following recommendation is made in this area:

- The General Assembly may wish to consider further amending Part Four of the Appropriation Act to require that the formal re-estimation of general fund revenues be done for future biennia.

Improvements Need to be Made in the Estimating, Reporting, and Collecting of Nongeneral Funds

For nongeneral funds, the relationship between estimates and budgeted amounts is not direct or clear. Nongeneral fund revenues can vary considerably from agency estimates. For fiscal year 1991, State agencies received an additional $477 million in nongeneral funds over estimates. Part of the problem is that estimating practices in the agencies vary considerably, and DPB is not meeting its responsibility to review the accuracy of agency estimates. Problems with the capture of nongeneral revenues by the State's accounting system also makes it difficult to compare revenues with estimates.

The following recommendations are made in this area:

- The Director of DPB should comply with Part Four of the 1991 Appropriation Act to ensure that the accuracy of nongeneral fund revenue estimates by agencies are reviewed and evaluated.

- The Department of Accounts (DOA) and DPB should examine ways to improve the reporting of nongeneral fund revenues to ensure that accurate evaluations of agency estimates against actual collections can be made and report their findings to the House Appropriations, House Finance, and Senate Finance committees.

- The General Assembly may wish to amend Part Four of the Appropriation Act to require the Governor to report annually on the receipt of additional nongeneral funds, their sources, and the amounts for all State agencies. In addition, for the 1994 Session of the General Assembly, DPB and DOA should conduct a study to identify sources of nongeneral fund revenue that might more appropriately be included in the general fund.

Executive Branch Appropriation Transfers Largely Comply With Legislative Intent

Appropriation transfers made by the executive branch in the 1989 and 1990 fiscal years were largely consistent with legislative intent at that time. In the 1991 Session, the General Assembly limited executive branch authority to transfer appropriations to 15 percent of the appropriation. However, the 15 percent limitation has not been effective in limiting the executive branch's transfer authority, if such a limitation was the legislature's intent. There is one recommendation in this area:

- The General Assembly may wish to amend Part Four of the Appropriation Act to strike the 15 percent limitation on transfers or strengthen the language to effectively restrict transfers, if such a limitation was the original intent.

Central Controls Provide Adequate Safeguards Over Expenditures, and Some Controls Could be Relaxed

Overall, central controls by DPB and DOA provide reasonable assurances that legislative intent regarding the type and level of expenditures is carried out by State agencies. In some areas, these controls could be relaxed to allow agencies greater flexibility. Recommendations in this area are listed below.

- The Director of DPB should promulgate the written guidelines that would allow systems of agencies to make appropriate operating budget appropriation transfers without DPB's prior approval.

- The General Assembly may wish to amend the *Code of Virginia* to reflect the current practice of annual allotments, deleting the requirement for quarterly estimates and allotments.

Agency Financial Management Appears Sound Even Though There Are Few Incentives for Sound Management

Agency directors are "to be responsible for all expenditures pursuant to appropriations," according to the *Code of Virginia*. A review of selected State agencies found that agency financial management appears sound and State funds appear to be spent appropriately. For the most part, agencies have adequate internal controls over their own expenditures. Agencies carefully monitor their expenditures to avoid deficits. In addition, there do not appear to be common financial management problems in agencies.

Good management occurs despite the fact that there are few incentives for agency directors to practice sound financial management. Currently, however, not all agency directors are formally evaluated on the financial management of their agencies.

Since 1988, the General Assembly has authorized the use of management standards. Meeting these standards would allow agencies such incentives as carrying forward a portion of their unexpended fund balances. However, these standards have been implemented only for higher education institutions.

Without the management standards, there is a lack of incentive for sound financial management. There is anecdotal evidence that some agencies spend as much as possible at the end of a fiscal year to prevent reversion of their monies to the general fund. As the General Assembly intended, management standards should be implemented for all State agencies, with additional incentives for sound financial management explored.

Suggested recommendations in this area include:

- The General Assembly may wish to consider requiring the executive branch to implement the financial management standards that are currently authorized in the Appropriation Act. In addition, the General Assembly may wish to consider allowing agencies the following incentive options: encumbrance of unexpended funds for specified purposes and the ability to keep a portion of funds from the reprogramming of their base budgets.

- The Secretary of Finance should study additional incentives for sound financial management, especially for agencies with significant amounts of nongeneral funds. The Secretary should report his findings on these incentives to the House Appropriations and Senate Finance committees prior to the 1993 Session of the General Assembly.

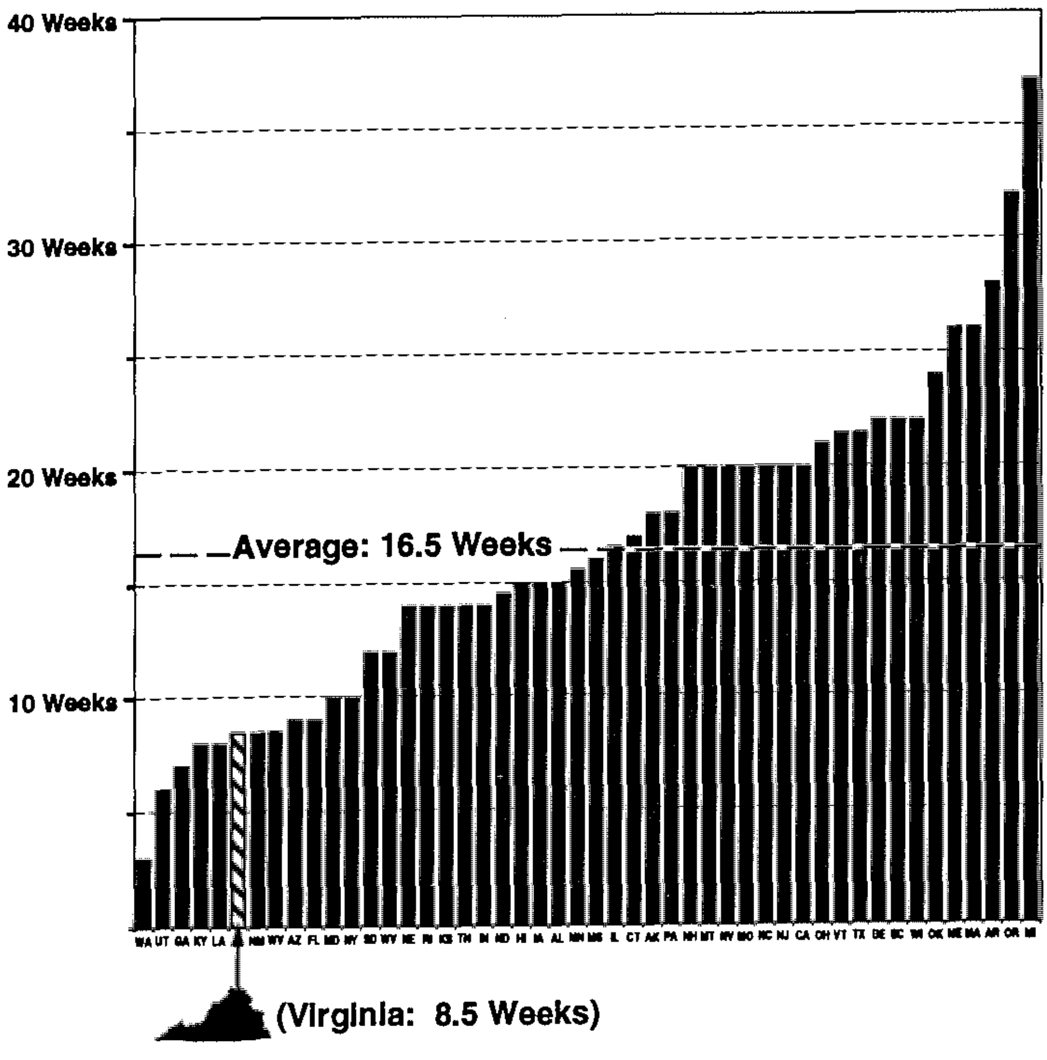
- The Secretary of Administration in conjunction with the Secretary of Finance should develop a uniform system for evaluating the financial management performance of agency directors.

The General Assembly Needs More Time to Consider the Executive Budget

The General Assembly has an extremely limited amount of time to consider the executive budget when compared to other state legislatures (see figure, next page). There are a number of options the General Assembly could consider to increase the amount of time for budget consideration. An earlier submission of the Governor's budget to the General Assembly would be the most straightforward of several viable options. Therefore, the following recommendation is made.

- The General Assembly may wish to amend the *Code of Virginia* to require submission of the Governor's biennial budget on December 20th. A similar change could be made to require the Governor's amendments to the Appropriation Act by December 20th as well.

States Compared for the Length of Time the Legislature Has to Consider the Budget Bill



Information in Agency Budget Proposals is Accurate and Timely, but its Appropriateness Varies

The *Code of Virginia* requires the Governor to have agencies follow a uniform format when submitting their biennial budget proposals. This practice allows comparisons of program needs across agencies. Although the majority of the agency budget proposals examined did follow a uniform format, there were exceptions. The separate format required for higher education institutions is necessary due to their unique reporting requirements and does not prejudice budgetary decisions for or against any institution. However, the modification of the format for individual agencies is not in compliance with legislative intent.

The *Code of Virginia* also requires that agencies be allowed to submit all addenda they deem necessary to meet their program needs. However, in some cases, agencies have not been given this opportunity because Governor's secretaries have restricted addenda submissions.

Recommendations in this area include:

- The General Assembly may wish to consider amending the *Code of Virginia* to reflect current practice and allow for a separate budget proposal format to be followed by all higher education institutions. In addition, the Director of DPB should ensure compliance with the *Code of Virginia* and require agency budget submissions to be in the uniform format prescribed by the Governor.

- The secretaries and the Director of DPB should ensure compliance with the *Code of Virginia* by ending the practice of restricting the addenda State agencies can submit.

Additional Budgetary Information Could Assist Legislators

During this review, legislators have indicated that additional information would assist them in making budget decisions. Some legislators would like information on funding for aid to localities contained in the Governor's budget. Other legislators would like information on discretionary and nondiscretionary funding in the Governor's budget. Information on total agency appropriations is also not readily available to legislators. This information is not provided in the budget bill or the Appropriation Act because agency line items do not include regrades and other central appropriations. Information currently provided in the budget bill for systems of agencies can be especially misleading.

Among the recommendations made in this area are the following:

- The General Assembly may wish to amend the *Code of Virginia* to require that the Governor's budget document include an identification of the portion of each State agency's budget that is direct aid to localities.

- If the General Assembly determines that the executive branch should provide information on discretionary and nondiscretionary funding, the director of DPB should work with the staff of the House Appropriations and Senate Finance committees to produce a definition of "discretionary" spending that can be agreed upon.

- The Comptroller should provide information concerning every agency's total appropriation for the current fiscal year in the existing *Monthly Report to the Governor* produced by DOA.

- The Governor may wish to consider modifying the way systems of agencies are currently reported in the budget bill by combining all agency codes within a system of agencies into one agency code.

Refinements to DPB's Operations Could Enhance the Budget Process

Many State agencies commented on DPB's professionalism during this review. Over the last 10 years, DPB has made significant strides in strengthening its staff capabilities. Agencies did identify several areas where refinements to DPB operations could enhance the budget process. Therefore, it is recommended that the Director of the Department of Planning and Budget should:

- Formally articulate the role of DPB analysts in the budget process, paying particular attention to their role *vis a vis* State agencies.

- Promote continuity in analysts' assignments during a biennial budget cycle.

- Encourage analysts to visit their assigned agencies by adopting an agency-wide policy that fosters these visits, and include the requirement for agency visits in the model performance expectations and position descriptions for analysts at all levels.

- Ensure that semi-annual training on the budget process is made available to agency directors and fiscal staff. The training should be structured so as to allow agencies an opportunity for providing input into DPB budget instructions and the budget development calender, as well as an opportunity for providing DPB with feedback regarding the budget process.

- Provide guidance to DPB staff and agencies concerning what sections of the *Commonwealth Planning and Budgeting System Manual* are still in effect. If the general guidance on the budget process included in the manual is no longer current or in effect, the director should provide alternative guidance to agencies.

- Continue to pursue the acquisition of personal computer analytical resources for all DPB budget and evaluation analysts. The director should also ensure that problems with the Program Budgeting System identified by DPB analysts during this review are addressed in the agency's information technology plan or as part of the agency's current effort to improve the system.

Note:

On December 16, 1991, the Chairman of JLARC announced that a comprehensive budget reform bill was prefiled to implement the recommendations from this report. Among the bill's provisions is a requirement that the Governor submit his budget to the General Assembly by December 20, rather than after the legislature convenes in January. The budget reform bill, as well as other legislation resulting from this study, will be considered during the 1992 Session of the General Assembly. Copies of this proposed legislation are included in Appendix D.

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I. Introduction

The State budget is an important document for Virginia government. It serves as a plan for future activities, as a benchmark for controlling the cost of State operations, as a management tool, and as a policy statement.

The executive budget process as defined in this study is the means used to develop, execute, and evaluate Virginia's operating budget. For budget development, a good process accurately relates revenues to spending. It assists decisionmakers in making deliberate choices among existing programs and new needs. For budget execution, the process requires enough flexibility to allow the executive branch to make changes, but sufficient controls and incentives to ensure that legislative intent regarding the type and level of expenditures is carried out. For evaluation, a good process informs decisionmakers about whether programs are meeting legislative intent and whether they are operating efficiently and effectively.

Overall, the process should provide adequate information for the legislature to make informed decisions about appropriations. It should also be managed in a way that assures agencies that thoughtful decisions about the State's funding needs are being made.

HISTORY OF VIRGINIA'S BUDGET PROCESS

Virginia's budget process has changed significantly over the years. The Executive Budget Act of 1918 implemented the executive budget process in the State, with the first executive budget presented to the General Assembly in 1920. A comprehensive assessment of the budget process was done by the Hopkins Commission in 1974, with one of their major recommendations being the adoption of program budgeting. Program budgeting was adopted by the General Assembly in 1975 and implemented by the executive branch in 1978. The State's budget process was modified again in 1981 to the basic process that exists today.

Budgeting Before the Hopkins Commission

Virginia was among the first states to introduce an executive budget. The establishment of the executive budget in Virginia was an outgrowth of the work of the Commission on Economy and Efficiency established by the General Assembly in 1916. The General Assembly approved the Executive Budget Act in 1918, making the Governor the chief budget officer of the State. The Governor was expected to plan, direct, and control the activities of State government within the policy confines established by the

General Assembly. In 1920, Governor Davis' staff prepared the first State budget, and in 1922 a Division of the Budget was established.

Prior to 1966, professional staff of the Division of the Budget consisted of a director, an assistant director, and an office manager. The budget was prepared biennially, and a management consulting firm was hired to review State agency budget requests. During Governor Godwin's first administration, the decision was made to create a permanent professional budget staff.

In 1970, the *Governor's Management Study* emphasized the value of program budgeting as a management tool. The study recognized that the State's budget planning and preparation process needed to be expanded and improved. The study also acknowledged that a closer relationship was necessary between the State's current programs and long-range plans. In other words, a better integration of long-term planning with the budget process was needed.

In 1972, with the establishment of the secretarial system, it appeared that a mechanism for a closer integration of planning and budgeting would be possible. With the then secretary of administration and finance serving as deputy budget officer for the Governor, a more clearly defined working relationship between the planning and budgeting functions of State government was envisioned.

Hopkins Commission

The Commission on State Governmental Management (referred to as the Hopkins Commission for its chairman — Senator Hopkins) studied Virginia's budget process in the early 1970s. Although the commission's charge was to examine all aspects of State government, the budget process quickly became a focal point because of its central importance. This was the first comprehensive assessment of the executive budget process since its establishment in 1918. According to the Department of Planning and Budget's *A Reevaluation of the Budget Process* (1984), the process that existed at the time the commission began its work resulted from "an accumulation of various actions over a period of years without a unifying theme, and was still dependent on manual calculations, the typewriter, and the adding machine."

In its third interim report, *Recommendations on the State's Budget Process*, the Hopkins Commission reported that planning appeared to have little relationship to the budget process and generally was not perceived to be an integral part of the decisionmaking process. This lack of integration was a "major concern" to the commission.

As an outgrowth of the Hopkins Commission's recommendations, the 1975 Session of the General Assembly mandated the adoption of program budgeting effective July 1, 1978. According to the current Department of Planning and Budget's *Agency Overview*, the General Assembly's intent in adopting this type of budget was to establish "a mechanism by which goals, objectives, programs, and resources can be organized, analyzed, and summarized for presentation to State policymakers to provide them with a more objective basis for decisionmaking." In addition, the General Assembly also established the Department of Planning and Budget (DPB) by merging the former Division of the Budget and the former Division of State Planning and Community Affairs. The General Assembly gave DPB responsibility for developing and directing an integrated policy analysis, planning, and budget process within State government.

The 1975 General Assembly also amended the *Code of Virginia* to require that the budget document be organized by function, primary agency, and proposed appropriation item. A copy of this legislation appears as Appendix B. The proposed budget for each agency and program had to be shown by major objects of expenditure such as personnel costs. In addition, program budgets had to clearly indicate the funding needed for the present level of service, an increased level of current service, and new services. The legislation also required workload indices and other criteria that could be used to evaluate programs as well as distinctions between mandated and discretionary funding.

Minor modifications were made to the program budgeting sections in the *Code of Virginia* in the 1976 and 1979 Sessions, but the program budgeting requirements remained largely intact. Program budgeting was implemented on a pilot basis during the 1976-78 biennium and began to be implemented statewide during the 1978-80 biennium.

Concurrent with the development of program budgeting in Virginia, new computer systems were developed to facilitate program budgeting. A computerized system for processing budget data at DPB, the Program Budgeting System (PROBUD), was developed and became operational July 1980. At the same time, revisions of the State's personnel and accounting systems were undertaken with the development and operation of the Commonwealth's Accounting and Reporting System (CARS) and the Personnel Management Information System. Appropriations, expenditures, and personnel were — for the first time — all recorded within the program structure.

Modifications Made in 1981

In 1981, the General Assembly amended Section 2.1-398 of the *Code of Virginia*. This amendment, which remains in effect today, requires that the Governor include a statement of the following in the budget: current, requested, and recommended appropriations for operating, fixed assets, and debt service expenses; cost to continue present services and any changes to present services; performance measures to be used in monitoring and evaluating programs and services; service attainments or lack of attainments; and service reductions or terminations for the biennium.

PHASES OF THE OPERATING BUDGET PROCESS

The State's budget process for the operating budget has four phases: budget development, appropriation, execution, and evaluation. Each phase has a specified timeline, includes input from specific participants, and has certain documents produced during it (Table 1). While the phases and intent of the budget process remain consistent between administrations, the activities during each phase can change with each Governor. For example, dissemination of policy guidance for agency biennial budgeting has changed with every recent Governor. During Governor Robb's administration, this guidance took the form of critical policy evaluation papers (white papers); while during Governor Baliles' administration it took the form of a very specific Governor's Guidance Memorandum for each agency. Governor Wilder, in December 1990, issued his first formal policy guidance to agencies in the report *Agenda for Virginia*.

Table 1

Phases of the Operating Budget Process

Budget Phase	Timeline	Documents Produced or Submissions Required	Primary Participants
Development	April - December	Governor's Guidance Budget Instructions Agency Base Budget and Addenda Proposals Executive Budget Document Budget Bill	Governor Secretaries DPB Agencies
Appropriation	January - March	Appropriation Act	General Assembly Senate Finance and House Appropriations Committees Governor
Execution	July - June	Agency Operating Plans *Monthly Report to the Governor* Prompt Payment Report	Governor Secretaries DPB Agencies DOA
Evaluation	July - June	Evaluation Reports	Governor Secretaries DPB Agencies APA JLARC

Source: JLARC analysis of DPB 1990-92 budget instructions and interviews with DPB, Department of Accounts (DOA), and Auditor of Public Accounts (APA) staff.

Budget Development

The budget development phase (also referred to as the planning or budget preparation phase) consists of two activities — revenue forecasting and executive budget development. The *Code of Virginia* requires that the Governor file, on an annual basis, a revenue forecast for a prospective six-year period, as well as for the upcoming biennium. Revenue forecasts are important because Virginia, like most states, has a balanced budget requirement, and the forecast indicates the maximum amount of funds available for expenditure.

For most State agencies, the operating budget is developed for the biennium in two stages. First, State agencies prepare their base and addenda submissions. The base includes existing programs and funding. Agencies are required to develop base budgets that do not exceed the established base budget amount. Addenda budget submissions, which are requests for new funding or positions, are also prepared by agencies.

The budget development process has been modified this year, making it a phased approach for the 1992-94 biennium. Agencies were first asked to prepare a baseline budget plan that balanced to their fiscal year (FY) 1992 amended appropriations. The second phase has consisted of a series of addenda submissions that focused on technical and policy issues. Agencies have received instructions for these addenda submissions throughout the summer and early fall.

The second stage of budget development begins when agency base and addenda proposals have been submitted to DPB. DPB is a major participant in budget development (Exhibit 1). DPB reviews agency proposals, develops alternative budget scenarios for gubernatorial review, and makes recommendations concerning agency budgets. These recommendations, coupled with input from the Governor's secretaries, develop into the operating budget portion of the Governor's executive budget.

The secretaries' role in budget development is also defined by the *Code of Virginia*. Generally, unless the Governor reserves such power for himself, secretaries are empowered to direct the formulation of a comprehensive program budget for their assigned functional area to then be considered by the Governor.

The Governor, as the "chief planning and budget officer of the Commonwealth" is required by the *Code of Virginia* (Section 2.1-387), to submit to the General Assembly for the first year of a biennium his budget bill that is "a tentative bill for all proposed appropriations of the budget." In addition, the Governor is also required to submit a budget document, which is more narrative in nature. For the second year of the biennium, the Governor submits his amendments to the bill, and customarily a narrative explanation of those amendments. (During the Baliles administration, a "budget tabloid" was also produced with information on the "State of the Commonwealth." The budget tabloid was produced only for the first year of those biennia (1988 and 1990). The budget tabloid is not required by the *Code of Virginia* and according to DPB staff will not be produced as part of 1992-94 budget development.)

Exhibit 1

Duties of the Department of Planning and Budget

- Development and direction of an integrated policy analysis, planning, and budgeting process within State government.
- Formulation of an executive budget.
- Policy and program analysis for the Governor.
- Continuous review of the activities of State government focusing on budget requirements in the context of the goals and objectives determined by the Governor and the General Assembly and monitoring the progress of agencies in achieving goals and objectives.
- Operation of a system of budgetary execution to assure that agency activities are conducted within fund limitations provided in the Appropriation Act and in accordance with gubernatorial and legislative intent.
- Assessment of the impact of federal funds on State government by reviewing, analyzing, monitoring, and evaluating the federal budget, as well as solicitations, applications, and awards for federal financial aid programs on behalf of State agencies.

Source: Section 2.1-391 of the *Code of Virginia*.

Appropriation

While the House Appropriations and Senate Finance committees are involved in budget review during the entire year, the formal appropriation phase (also known as the legislative budget process) begins when the Governor's budget bill is submitted to both the House of Delegates and the Senate in January. Once the Governor's budget bill is submitted, it is referred to the House Appropriations Committee and Senate Finance Committee for consideration.

Within the committees, functional area subcommittees are formed to review the budget in specific areas. The subcommittees recommend changes to the budget bill to the full committees. The House Appropriations and Senate Finance committees vote on their respective subcommittee recommendations and, if agreed to, they become amendments to the budget bill.

Both versions of the budget bill, with amendments, are then presented to their house of introduction as a bill on second reading. Both houses typically have two days to review the amended bills before they appear on the calendar. General Assembly members may submit floor amendments at this time. Once all amendments are voted upon, the bills are engrossed and are on third reading.

Once the amended budget bills are passed on third reading in both houses, they are sent to the other house for concurrence. Typically, concurrence does not occur because there are variations in the bills. Therefore, a conference committee is formed to resolve these differences. It is comprised of six senior members, three each from the House Appropriations and Senate Finance committees.

A budget conference report is submitted to both houses prior to Session adjournment. Both houses must vote on the budget conference report as reported — it cannot be amended. Once the report is passed by both houses it becomes known as the Appropriation Act.

The Appropriation Act becomes law once it is signed by the Governor or when the General Assembly approves the Governor's recommended amendments in a reconvened session. The Governor also has certain veto powers over the Act. The *Constitution of Virginia* does not specifically prevent the Governor from vetoing the Appropriation Act as a whole, although this has never been done. The Governor does have the authority to veto line-item dollar amounts in the Appropriation Act, an item being defined as an indivisible sum of money dedicated to a stated purpose. Governor Wilder vetoed several items in the 1991 Appropriation Act. This was the first time since 1976 that a Governor exercised this authority.

In addition to the Appropriation Act, the General Assembly can take other appropriating actions. These include lottery appropriation acts, revenue bond acts, and special relief bills.

Budget Execution

The execution phase of the budget process begins after the Governor signs the Appropriation Act and continues until June 30 of the next year. Execution is the implementation of the Appropriation Act by the executive branch.

At the beginning of the execution phase, DPB sends agencies their allotments, making the funds available to the agencies for expenditure. The allotment represents the total legislative authority granted to an agency in the Appropriation Act.

DPB monitors agencies to ensure that they do not exceed their total allotment. However, there are provisions allowing changes to agency allotments during the fiscal year. The Governor has the authority to reduce allotments, within limits, in the event revenues fall below forecasts. The Governor can also authorize deficits for agencies that expend more than their allotment. In addition, the Governor, or his designee, can authorize appropriation transfers between agencies and between programs within agencies.

The Department of Accounts plays a large role in the budget execution phase of the budget process. DOA's main budget-related tasks include:

- completing expenditure analyses including an examination of negative cash balances, expenditure and allotment tracking, and straight-line projections of end-of-year agency expenditure totals;
- auditing expenditures to ensure compliance with State laws and supporting administrative regulations (pre-audit);
- monitoring agency accounts payable and accounts receivable;
- loading the Appropriation Act amounts on CARS; and
- forecasting cash balances for the current and next fiscal year.

In addition, DOA participates in a task force with DPB to discuss and resolve issues related to the budget process as well as other topics.

Evaluation

Evaluation in Virginia is completed by both the executive and legislative branches. Executive evaluations that impact the budget process are typically conducted by DPB or State agencies. Evaluation activities at DPB primarily occur in its five budget sections and its evaluation section. The Department of Planning and Budget's budget analysts routinely conduct financial and policy evaluations of agency base budget and addenda proposals. DPB's evaluation section was created in 1983 and has completed 38 studies that range from staffing studies to analytical studies in support of gubernatorial or secretarial commissions.

State agencies also conduct evaluations that impact the budget process. Evaluations completed by State agencies can include organization and management studies, policy studies, and program evaluations. The type and level of sophistication of agency-based studies can vary.

The legislative branch is also involved in the evaluation phase of the executive budget process. The two main participants in legislative oversight and evaluation are the Auditor of Public Accounts and JLARC.

The *Constitution of Virginia* provides for an Auditor of Public Accounts. The APA's major activities include auditing the accounts and financial records of State agencies and institutions and local government offices which collect State taxes and fees; approving accounting systems developed for State agencies and institutions for adequacy of audit trails and financial control; prescribing systems of accounting for local governmental offices and agencies; providing specifications to be followed by Certified Public Accounting firms in their audits of counties; and preparing annual comparative cost reports of counties and cities. The audits the APA conducts of State agencies are primarily financial in nature and generally do not evaluate the performance of State programs. APA audits are conducted after the end of every fiscal year.

The Joint Legislative Audit and Review Commission also provides legislative oversight. The duties of the Commission and the nature of its studies are specified in Section 30-58.1 of the *Code of Virginia*. Commission studies are to address:

- ways in which agencies may operate more economically and efficiently;
- ways in which agencies can provide better services to the State and to the people; and
- areas in which functions of State agencies are duplicative, overlap, fail to accomplish legislative objectives, or for any other reason should be redefined or redistributed.

JLARC, under the auspices of the Legislative Program Review and Evaluation Act, reviews and evaluates all program functions of State government on a rotating basis.

SIZE OF VIRGINIA'S BUDGET

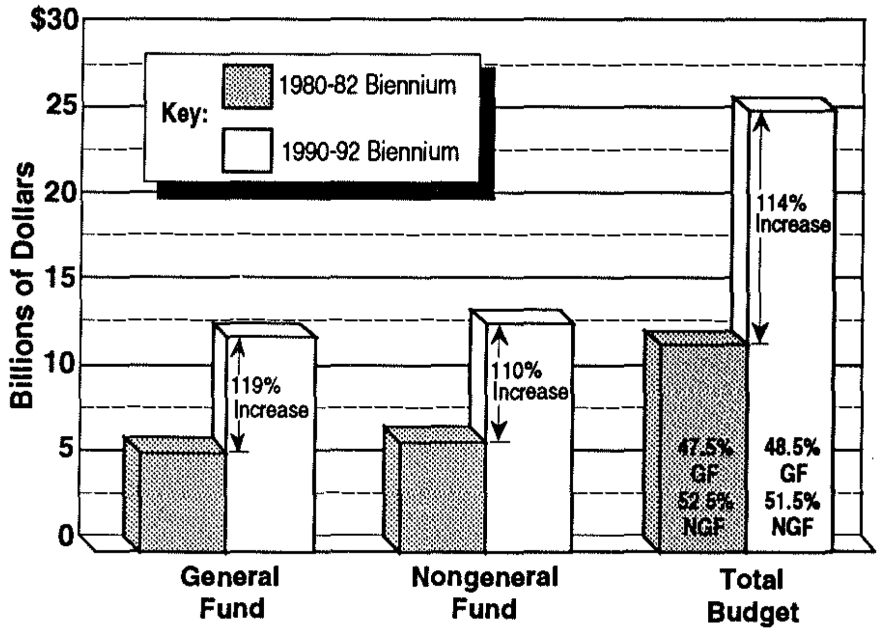
Virginia's budget for the 1990-92 biennium, as passed by the 1991 General Assembly, was in excess of $25.6 billion. Of this, approximately $25.3 billion was budgeted for operating expenses. The remainder ($349 million or 1.4 percent) was budgeted for capital projects. General fund revenues comprised 48.5 percent of the budget with nongeneral funds contributing the rest. Revenues in the general fund come from taxes and fees not designated for any specific purpose and are utilized for general, ongoing government services. Nongeneral fund sources include federal, trust and agency, dedicated special revenue, higher education operating, and special revenues derived from specified taxes or other earmarked sources.

The State's budget has grown substantially over the last five biennia (Figure 1). The total budget for the State has grown by $13.7 billion, or 114 percent, since the 1980-82 biennium. On a total dollar basis, nongeneral fund revenues comprised slightly more of the budget than did general fund revenues. On a percentage basis, the general fund portion of the State's budget increased from 47.5 percent of the total budget for 1980-82, to 48.5 percent for 1990-92.

Inflation over the same period grew by 57 percent. Predominate areas where spending growth occurred in the budget over this period include transportation, Medicaid, and corrections.

Figure 1

Size of Virginia's Budget (1981 to 1991)



GF - general fund
NGF - nongeneral fund

Source: JLARC analysis of 1981 and 1991 Appropriation Acts.

THE JLARC REVIEW

Item 13 of the 1990 Appropriation Act (amended and reenacted in the 1991 Session) directed JLARC "to review the Commonwealth's executive system of financial planning, execution and evaluation." The item further specified that the scope and duration of the review should be determined by the Commission, and that reports should be made to each Session of the General Assembly until work was completed. Because of the mandate's emphasis on Commission direction, a subcommittee of the Commission (the Subcommittee on the Executive Budget Process) was formed to guide JLARC staff in their work.

In 1990, the efforts of the JLARC Subcommittee and staff were focused on revenue forecasting. As a result, two JLARC studies were produced for consideration by the 1991 Session of the General Assembly — *Revenue Forecasting in the Executive Branch: Process and Models* and *Proposal for a Revenue Stabilization Fund in Virginia.*

This year, research has focused on Virginia's executive budget process, specifically the development, execution, and evaluation of the operating budget. The result of this research is the subject of this report. It is the first comprehensive review of Virginia's executive budget process since the 1970s.

In addition, the Subcommittee and JLARC staff are continuing to examine options for increasing legislative involvement in revenue forecasting. This research effort remains ongoing. A review of the operations and management of the Department of Taxation (added to Item 13 during the 1991 Session) has also been undertaken and will be addressed in a separate report.

Study Scope

To evaluate the executive budget process, a comprehensive review was completed by JLARC staff on activities which occur within the development, execution, and evaluation phases. The State's operating budget is the focus of this study. JLARC previously reviewed aspects of capital budgeting in 1978 and 1987 and is currently scheduled to begin a study of capital outlay in higher education. Therefore, capital budget process issues were not examined.

Even though an examination of the legislative appropriation process was not part of the study mandate, it is important that the executive budget process provide legislators with the information they need to make deliberative decisions. Also, legislators have raised concerns that the time they have to review the executive budget is inadequate. Changes in this area could potentially impact budget development and, therefore, were examined during this review.

An assessment of the organization and management of the central agencies involved in the budget process was not part of the mandate for this study. However, throughout this review, agencies have raised issues regarding central agency management of the process. Some of these issues result not from the process itself but from frustrations with the current budget shortfall and consequent decisions made by the Governor or General Assembly. This report addresses only those issues that were related to the process.

Finally, because the first budget of the current administration will not be submitted to the General Assembly until January 1992, budget development activities for the 1992-94 budget could not be fully examined and assessed.

Research Activities

A number of research activities were undertaken during the study. These activities included: a survey of State agencies, case studies of selected State agencies, telephone interviews with other states, structured interviews, file reviews, and secondary data and document reviews.

Survey of State Agencies. Information concerning the budget process was collected from State agencies using a mail survey. Only executive branch agencies with primary responsibility for budgeting were surveyed. For executive branch systems of agencies (the Department of Corrections; Department of Mental Health, Mental Retardation, and Substance Abuse Services; and the Virginia Community College System), surveys were sent only to the central office of the system. A total of 88 State agencies were surveyed and the response rate was 100 percent. Questions on the survey focused on DPB assistance to the agencies, automated systems used for budgeting, the adequacy of the program structure, performance measures used by agencies, and the effects of recent budget reductions.

Case Studies of State Agencies. In order to do an in-depth examination of how the budget process works in agencies (and the impact the process has on agencies), 11 State agencies were used as case studies. Agencies were selected by functional area of government and efforts were made to include agencies of different sizes, with different fund sources. The selected agencies are listed below.

- Department of Air Pollution Control
- Department of Corrections (Adult Services)
- Department of Economic Development
- Department of Education
- Department of Fire Programs
- Department of Mental Health, Mental Retardation, and Substance Abuse Services
- Department of Personnel and Training
- Department of Rehabilitative Services
- Department of Transportation
- Department of the Treasury, and
- Old Dominion University.

Each agency was visited at least four times. In-depth interviews were conducted with agency directors (or their representatives) and with budgeting and accounting personnel.

Telephone Interviews with Other States. Structured telephone interviews were conducted with legislative staff in 14 states concerning their state's budget process. States using different types of budgeting were selected. States included were Arkansas, Florida, Georgia, Hawaii, Indiana, Kansas, Kentucky, Maryland, New Mexico, North Dakota, Ohio, Oregon, Tennessee, and Wyoming. Questions focused on the type of budgeting the state uses, base budget development, financial management by agencies, the use of performance measures, and evaluation activities in the budget process. However, it should be noted that each state's budget process is unique, thus comparisons among states' budget processes can be of limited utility.

Structured Interviews. More than 100 structured interviews were conducted with a variety of participants involved in the budget process. In DPB, the director, deputy directors, section managers, and 17 analysts were interviewed. Eleven of these analysts were those assigned to the case study agencies mentioned earlier. The secretary of finance, former gubernatorial secretaries, the comptroller, Department of Accounts staff, the Auditor of Public Accounts and members of his staff, staff of the State Council of Higher Education for Virginia, and staff of the House Appropriations and Senate Finance committees were also interviewed.

File Reviews. File reviews were conducted at the Department of Planning and Budget. Analyst working papers for case study agencies were examined for information on base budget target development, review of agency biennial budget proposals, the estimation of nongeneral funds, and program evaluation activities. In addition, DPB files of all agency requests for changes to the State's program structure for the last three biennia were examined. Finally, DPB central files detailing execution activities in 44 agencies in each of two fiscal years (1989 and 1990) were reviewed.

Secondary Data and Document Reviews. A wide variety of both secondary data and documents were used in the study. Secondary data from PROBUD were used to examine executive branch execution activities. In addition, expenditure data from the APA for each case study agency for fiscal years 1987 through 1991 were used. A partial listing of documents reviewed by JLARC staff include: the *Code of Virginia*; Attorney General's opinions; State budget documents including agency proposals, executive budget documents, and Appropriation Acts; executive orders; evaluations of State agency programs and activities; previous studies and reports concerning the executive budget process; and policy and procedure manuals that guide the budget process. For each case study agency, budget submissions for the last three biennia were also examined. Throughout the study, JLARC staff reviewed professional literature on budgeting and fiscal management and studies conducted by other states and national organizations.

Report Organization

This report examines the process used by the executive branch to develop, execute, and evaluate the State's budget. This chapter has outlined the study mandate, presented an overview of the executive budget process and the size of Virginia's budget, and identified the study approach and research methods used for the study. Chapter II examines budget development, including the type of budgeting used by the State and the relationship of revenues to the budget. Chapter III assesses the budget execution activities of the executive branch, including incentives for good financial management by State agencies.

Chapter IV explores evaluation in the budget process, including the advantages and disadvantages of performance measures. Chapter V discusses the adequacy and timeliness of information the executive branch provides the legislature during the budget process. Areas where refinements to DPB's operations could enhance the budget process are discussed in Chapter VI. Finally, the study mandate, a copy of the legislation establishing program budgeting, the Department of Planning and Budget's response to this review, and pending legislation related to this report are included as appendixes.

II. Budget Development

In response to the findings of the Hopkins Commission, the General Assembly adopted program budgeting in the mid-1970s as a way to integrate planning into the budget process. The legislature adopted a comprehensive and rigorous model of program budgeting. Meeting the requirements of this model proved difficult for State agencies, resulting in excessive, time-consuming paperwork that Virginia's citizen legislature and central budget office did not have time to effectively review.

Over time, some difficult to implement requirements were eased by the executive branch. These departures from the model program budgeting system initially established by the legislature appear to have been generally supported by the General Assembly. As a result, the type of budgeting used by the State has evolved to be largely incremental. The *Code of Virginia*, however, still reflects many of the initial, stringent requirements. Legislative intent regarding program budgeting could be clarified by amending the *Code of Virginia* to delete some of its more stringent and unnecessary components, keeping only those requirements that are key to a sound program budgeting system.

Using incremental budgeting, because of its inherent characteristics, has had certain consequences. While financial assessments of agencies' base budgets have been routinely done, rigorous evaluation of the objectives, efficiencies, and impacts of the programs in these base budgets has taken place episodically. That does not mean that there is widespread overspending in agencies' base budgets (especially in light of recent budget reductions). It does mean that choices between existing programs and current and future needs are not made in a comprehensive and systematic way. Recent budget reductions appear to have forced the Department of Planning and Budget (DPB) and other State agencies to examine opportunities for downsizing and cost savings based on the effectiveness of selected State programs. However, there is no guarantee this type of examination will continue when revenues improve. Therefore, program evaluations of base budgets needs to be done on a systematic basis by selecting specific programs for targeted review in each biennial budget cycle.

Finally, in a sound budget development process there is a clear relationship between forecasted revenues and budgeted amounts. This is important in Virginia because the Governor is constitutionally required to ensure that expenditures do not exceed revenues during a biennium. Consequently, it has been custom and practice for the Governor to submit, and the General Assembly to pass, a balanced budget. The relationship between general fund revenue forecasts and the budget is clear. For nongeneral funds, however, the relationship between estimates and collections is less clear.

EVOLUTION OF VIRGINIA'S USE OF PROGRAM BUDGETING

The program budgeting requirements established by the General Assembly in the mid-1970s and early 1980s were ambitious. While some of these requirements are still being used, others are not used on a systematic basis. During interviews with case study agencies, Department of Planning and Budget staff, and other participants involved in the process, few maintained that the State currently uses program budgeting in its original, model form.

Initial Legislative Intent Regarding Program Budgeting

In 1975, the General Assembly amended Sections 2.1-54, 2.1-60, and 2.1-61 of the *Code of Virginia* and laid the foundation for the State's implementation of program budgeting (Appendix B). This amendment was the result of the recommendations of the Hopkins Commission. In its report, the Commission stated "the budget process is not simply a mathematical exercise. It is the process whereby the State enunciates its basic policies and determines the priorities being assigned to competing programs." The intent was that the budget process would become a means for prioritizing resources and programs. It would also provide information on goals, objectives, and programs that would provide the legislature and other budgetary decisionmakers with objective information for well-grounded decisionmaking.

The executive branch fulfilled legislative intent and operationalized the *Code of Virginia* requirements. These requirements, as outlined in the *Commonwealth Planning and Budgeting System Manual*, were:

- articulation of program needs;
- identification of common efforts and services;
- statement of program goals and objectives (both short- and long-term);
- establishment of program priorities;
- appropriation of funds according to programs;
- monitoring and evaluation of programs;
- presentation of information so policy implications of decisions are understood;
- requirement for justifications of programs;

- requirement of performance measures for programs; and

- identification of alternative approaches to obtaining goals.

Initial Program Budgeting Requirements Were Difficult to Implement

From 1978 to 1982, the executive branch made a concerted effort to use program budgeting as it was originally envisioned by the General Assembly. According to State agency personnel who were involved in the process at that time, this level of program budgeting was cumbersome and time-consuming to implement. According to an analysis conducted by DPB staff on the 1980-82 budget development process, agencies used an average of 24 full-time equivalents when developing their budget. The development had to begin approximately a year before the budget document was due to the General Assembly. In addition, the executive budget document for the same biennium was four volumes and more than 1,300 pages.

State agency staff have also indicated that the results of the process they went through were not used by DPB staff when making budget recommendations to the Governor. Therefore, they felt that much of the time they spent preparing the budget was wasted. As one agency budget director stated: "There was a lot of time and paperwork involved . . . . To go back would be time consuming and given today's climate you would have to go back and build the whole thing again." Legislative staff involved in the budget process at the time agreed that the paperwork produced to meet the initial requirements of program budgeting was excessive. They noted that most of the effort was useless to budgetary decisionmaking.

Other states interviewed during this review expressed similar concerns indicating that program budgeting always appears to require an excessive amount of resources and time. Tennessee further stated that program budgeting in its model form overemphasizes the process. Like Virginia, many users of program budgeting have developed more realistic requirements.

Some Statutory Requirements of Program Budgeting Are No Longer Followed

In recognition of the burden of the initial program budgeting requirements, some changes were made by the 1981 General Assembly to reduce some of this paperwork. The *Code of Virginia* (Section 2.1-398) was amended to simplify the use of program budgeting and the budget process (Exhibit 2). This language is still in effect. It requires that the Governor articulate his goals, objectives, and policies for each State program, as well as the performance measures that will be used to monitor and evaluate State services and programs.

Exhibit 2

Current Program Budgeting Requirements in the *Code of Virginia*

"Within five days after the beginning of each regular session held in an even-numbered year of the General Assembly, the Governor shall submit to the presiding officer of each house printed copies of a budget, based on his own conclusions and judgment, containing the following:

> **A statement of the Governor's proposed goals, objectives, and policies** in the areas of administration of justice; education, including intellectual and cultural development; individual and family services; resources and economic development, including specific references to economic development and management of natural resources; transportation; general government, including therein or as separate categories areas of multiple impact, such as telecommunications, energy, and urban development.
>
> **A statement organized by function, primary agency, and proposed appropriation item which sets forth**: related programs and sources of funds for appropriation items; current, requested, and recommended full-time equivalent employment levels; **costs to continue present services, and either separately or in combination, the costs to provide for changed and new services; services to be offered, recipients of services, and program measures to be used in monitoring and evaluating services; service attainments or lack of attainments and service terminations or reductions for the biennium**; and authority for services offered, such as federal or state statute, or a discretionary inclusion."

Source: Section 2.1-398 of the *Code of Virginia*. Emphasis added (**bold** type).

Beyond these statutory changes, the executive branch has further reduced the number of program budget requirements on State agencies. Not all the requirements still in the *Code of Virginia* have been used systematically in the budget process since the 1982-84 biennial budget. During this review, little evidence was found of the systematic implementation of the following program budgeting criteria since 1982-84:

- articulation of program goals and objectives;
- establishment of program priorities;
- monitoring and evaluating of programs and communication of those activities;

- use of performance measures; and

- articulation of program needs.

Rather, the executive branch appears to use some program budgeting criteria when developing the budget addenda. For example, a DPB budget analyst will evaluate selected addenda that are included as part of an agency's biennial budget proposal. The analyst may identify alternatives, determine the priority of the addenda request, and explain the program's goals and objectives. However, this same process is typically not used when reviewing an agency's base budget.

During two early 1980s reviews of the implementation of program budgeting, these same concerns were identified. In 1981, a report by a former staff member of the Hopkins Commission determined that the areas of program budgeting not fully implemented by the executive branch were planning, policy and issue analysis, and program evaluation.

In 1982, the Department of Management Analysis and Systems Development (MASD) review of DPB found concerns in four areas. These were the lack of program analysis; the use of targeting; nonuse of program proposals (justifications) by DPB staff; and limited review and evaluation, including program evaluation.

In addition, a review of budget documents confirms that after the 1982-84 budget document not all *Code of Virginia* requirements were being fulfilled. As shown previously in Exhibit 2, the *Code of Virginia* specifies that certain items will be included in the document. However, this review indicates that not all requirements, particularly those required in order to be a program budget, have been included on a systematic basis since the 1982-84 budget document (Table 2).

For example, the 1982-84 budget document included such program information as recipients of services and program measures to be used in monitoring and evaluating services. In biennial budget documents since then, this information has not routinely been included. Similarly, program goals and objectives were included in each executive budget document until the 1986-88 biennium. During the 1986-88 and 1988-90 biennia, broad policy goals were included in the budget tabloid, a separate document. For 1990-92, few goals and objectives were clearly articulated.

Virginia's Process Has Evolved into a Manageable Budgeting Process

When Virginia's process is assessed against professional literature and other states' budgeting characteristics, it becomes clear that the State is for the most part using an incremental process. Incremental budgeting is defined as the process whereby an agency's previous year budget serves as its base for the next year and special attention is usually given to a relatively narrow range of increases and/or decreases.

The executive branch establishes a base or target for each agency, assuming that current programs are essential and the continued growth of existing activities and

Table 2

Executive Budget Document Content Compliance with *Code of Virginia*

Requirement	Biennium 1982-84	1984-86	1986-88	1988-90	1990-92
Statement organized by function, agency, and appropriation item which sets forth:					
a. related program & sources of funds for appropriation items	✔	✔	✔	✔	✔
b. current, requested, & recommended appropriations for operating, fixed assets, & debt service expenses	✔	✖	✖	✖	✖
c. current, requested, & recommended full-time equivalent levels	✔	✔	✔	✔	✔
d. costs to continue present services, & either separately or in combination, the costs to provide for changed & new services	✔	✔	✔	✔	✔
e. services to be offered, recipients of services, & program measures to be used in monitoring & evaluating services	✔	✖	✖	✖	✖
f. service attainments or lack of attainments & service terminations or reductions for the biennium	✔	✖	✖	✔*	✖
g. authority for services offered, such as federal or State statute, or a discretionary inclusion	✔	✖	✖	✖	✖
Statement of the Governor's proposed goals, objectives, and policies in the areas of:					
a. administration of justice	✔	✔	✖	✔**	✖
b. education, including intellectual and cultural development	✔	✔	✖	✔**	✖
c. individual and family services	✔	✔	✖	✔**	✖
d. resources and economic development, including specific references to economic development and management of natural resources	✔	✔	✖	✔**	✖
e. transportation	✔	✔	✖	✔**	✖
f. general government, including therein or as separate categories areas of multiple impact, such as telecommunications, energy, and urban development	✔	✔	✔***	✔**	✖

*Limited use, not consistent throughout the document.
**The 1988-90 budget tabloid, "Virginia Leading the Way," included information on policy goals.
***Included information on telecommunications only.

Source: Section 2.1-398 of the *Code of Virginia* and the executive budget documents for the 1982-84 through 1990-92 biennia.

Key:
✓ - Budget document complies with requirement
✖ - Budget document does not comply with requirement

programs. In addition, through the use of incremental budgeting attention is focused on a relatively small portion of a budget — the change increment. Relatively little examination of the programs comprising the base occurs. The strength of incrementalism is that it focuses maximum attention on changes and does not dilute the review process by revisiting each and every budget choice made in the past. The weakness of incrementalism is that, over time, some of these past budget choices do need to be revisited and incrementalism does not systematically identify where such review is needed.

The lack of a program budgeting process and the reliance on an incremental process is openly acknowledged by the executive branch:

- The Director of DPB as well as the deputy director for budgeting acknowledged that the State's budgeting process is essentially incremental.

- The 11 DPB budget analysts interviewed and their section managers stated that the State does not use program budgeting in its model form.

- Nine of the 11 case study agencies said that the State uses incremental budgeting.

Further, several legislative staff have also acknowledged that the executive budget at the agency and State level is developed incrementally.

While the overall process is essentially incremental, some components of program budgeting are still maintained by the executive branch. For example, there is a useful statewide program structure for organizing similar operating programs and activities. However, as mentioned previously, few participants in the process believe that the State is using program budgeting. This is illustrated by the following comment from a response to the JLARC survey of State agencies:

> One of the biggest services DPB could provide is dealing once and for all with program budgeting. If Virginia is going to use program budgeting, then let's use it. If we're going to continue to use incremental line-item budgeting, then let's at least admit that that's what we're going to do and stop fooling around with all the unnecessary paperwork we prepare and process to maintain the appearance that we're using program budgeting.

Clarifying Legislative Intent Regarding Program Budgeting

Legislative intent regarding program budgeting could be clarified by amending the *Code of Virginia* to remove the requirements that are too burdensome on State agencies, keeping only those requirements that are key to gubernatorial and legislative decisionmaking.

The legislature could reaffirm its commitment to program budgeting, while still recognizing the need for practical implementation by only including the following components of program budgeting in the *Code of Virginia*:

- identification of common efforts and services;
- appropriation of funds according to programs;
- identification of service attainments or lack of attainments (service attainments could include clients served or broader program evaluations); and
- articulation of program justifications, including goals, objectives, and the authority for the program.

Recommendation (1). **The General Assembly may wish to consider clarifying legislative intent regarding executive budget development by amending Section 2.1-398(4) of the *Code of Virginia* to include only the following requirements of program budgeting: identification of common efforts and services; appropriation of funds according to programs; identification of service attainments or lack of attainments; and articulation of program justifications, including goals, objectives, and the authority for the program.**

While adoption of this recommendation would provide for more realistic budget development requirements, other consequences of using incremental budgeting must also be addressed.

CONSEQUENCES OF VIRGINIA'S APPROACH TO BUDGETING

Using incremental budgeting, by definition, has had certain consequences. Agency budgets are no longer developed based on program needs and little consideration has been given to rising costs, including inflation. Financial assessments of agencies' base budgets have been routinely done, as have policy analysis and financial assessment of addenda. However, program evaluation of the programs in base budgets has taken place sporadically. Recent budget reductions appear to have forced the Department of Planning and Budget and other State agencies to make choices between some existing programs. There is no guarantee, however, that examination of base programs will continue when revenues improve. Therefore, rigorous program evaluations of agencies' base budgets need to be done on a systematic basis by targeting selected programs for review during each biennial budget cycle.

Agency Base Budgets Are No Longer Developed Based on Program Needs

When program budgeting was implemented, it was envisioned that agencies would develop their base budgets from a program perspective. They would identify and prioritize their program needs and submit these needs to the Governor. The Governor then would weigh competing needs and determine the amount of funding each agency would receive to address its program needs. However, this "bottom-up" budget development process is no longer used.

During the mid-1980s, the executive branch formally adopted the methodology of establishing an agency's biennial base budget by doubling the previous year's appropriation to an agency — essentially an incremental process. This process is still used. It begins with an agency's second year operating expense appropriation (Table 3). DPB adds to this amount for items which were partially funded, while deducting amounts for any one-time expenses. This total is then multiplied by two to obtain the agency's adjusted biennial appropriation. Finally, any compensation changes are added or subtracted to the adjusted biennial appropriation. The resulting figure is the agency's base budget.

Inflation Is Typically Not Addressed During Base Budget Development

Agencies do not receive funding for inflation as part of their base budget. Instead, according to DPB, agencies must submit an addenda request to outline their inflation requests. These addenda are not designed to request additional funds for program needs but rather to maintain the current level of services. This is exemplified in the Department of Mental Health, Mental Retardation, and Substance Abuse Services' addenda request for 1990-92. The addenda reads:

> The base budget for the Department of Mental Health, Mental Retardation, and Substance Abuse Services contains no increase for non-personal expenditures during the 1990-92 biennium. This, of course, is unrealistic since there will be inflationary increases.... Many non-personal costs are nondiscretionary and cannot be reduced if services are to be provided to clients. Therefore, to meet inflationary increases on non-personal line items, positions would have to remain unfilled and client services decreased. Ultimately, this could jeopardize accreditation in the facilities.

Further, three of the case study agencies indicated that they had put in such addenda requests and that those were only partially funded. Department of Education personnel said that DPB had never told them they could put in addenda for inflation (except for a postage increase for one year), while Department of Air Pollution Control personnel believed that they were not allowed to submit addenda for that purpose. The Department of Rehabilitative Services stated that their DPB analysts discouraged an inflation addenda.

Agencies contend that the level funding of nonpersonal services is taking its toll on programs. Only two of the 11 case study agencies believe the programs in their bases are fully funded, and these two agencies have their own dedicated nongeneral fund revenue sources. The other nine agencies added that their programs were not fully funded even before the recent budget reductions.

Table 3

Example of the Formula Used to Develop an Agency's Base Budget (Using the Department of State Police)

	Step in Formula	Funding	MEL*
1	Second Year Operating Appropriation	$105,178,307	2,305
2	Additions to Appropriation	+ $ 1,902,800	5
3	Subtractions from Appropriation	− $ 3,828,000	2
4	Adjusted Second Year Operating Appropriation	$103,253,107	2,308
		X 2	
5	Adjusted Biennial Appropriation	$206,506,214	2,308
6	Compensation Adjustments	+ $ 24,352,107	N/A
7	Base Budget	$230,858,321	2,308

*MEL - maximum employment level.

Source: Governor's Guidance Memorandum for 1990-92 Budget Development, Department of State Police, May 8, 1989.

Five of the nine DPB analysts who were asked believed the lack of inflation factors in base budget development has hurt general fund agencies in particular. The other four analysts believed it has had a positive impact, making agencies look for efficiencies.

According to the Secretary of Finance, including inflation in agency base budgets was stopped in the early 1980s because the inflation adjustment alone was outpacing additional revenues. Further, the level-funding policy was adopted to encourage closer scrutiny of the base and identification of low priority programs or needs, according to the secretary.

Realistically, routinely including an inflation factor for all State government programs would consume a large portion of any additional revenues, making that funding unavailable for new initiatives or changing program needs. For example, over the last decade, inflation increased by 57 percent. On the other hand, not acknowledging the effects of inflation has resulted in diverting funding for new programs to support the base, as shown in the following section.

Some Agencies Use Additional Funding Received for New Programs or Staff to Maintain Current Services

Case study agencies have indicated that they have been using funding they had received in addenda for new programs or services to fund the programs in their base. In all but one case where new programs were added in the case study agencies, the agency received additional funding. Some of the funding may be diverted, however, to existing programs as the following examples illustrate.

> *One agency administrator stated during an interview that his agency "may get funding for new initiatives but not use it all for the new initiatives. Two years ago, we got slapped on the wrist for being more than one percent over our salary appropriation. The reason we were almost two percent away was that we used the money in other ways."*
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> * * *
>
> *Another agency stated that in order to continue providing the current level of services they keep the vacancy rate high so that they can pay their bills. In addition, fiscal staff stated "in recent years there has been no opportunity to file for it [inflation] . . . . If we would have had full funding, we wouldn't need to use new full-time equivalent positions [received through the addenda process] to survive." They stated that "you survive on turnover and vacancy."*

As a result, funds that the legislature thought were going to address one need may be used for entirely different needs. In addition, information on program costs may not be accurate.

DPB Could Better Focus Its Efforts on Programmatic Examination of Agency Base Budgets

DPB has outlined what the examination of base budget programs should include. However, consistent with incremental budgeting, it appears that DPB has moved away from a programmatic examination of the base to a financial assessment of the base. For example, DPB budget analysts verify that agencies are fully funding personal services and they question funds budgeted for nonpersonal services at the line item — not program — level. Four of the 11 case study agencies indicated their base had been changed by DPB in the past. In only one of the four had the change resulted in decreased funding. In none of the four were actual programs eliminated or extensively modified by DPB.

Current Programmatic Examination of the Base by DPB is Episodic. Five of the ten case study agencies whose fiscal staff had been in the agency during 1990-92 budget development said that little interaction with DPB occurred on the base and that interaction was mainly on their addenda request. Two agencies indicated that interaction varies from biennium to biennium. Two other agencies indicated extensive interaction with DPB on their base; one indicated no interaction at all on their base. DPB analysts' perception of this interaction was quite different from that of the agencies. Five of the six analysts asked indicated that interaction with their agencies in 1990-92 budget development was on both addenda and the base budget. Only one analyst said that the interaction occurred only on addenda, although three of the five analysts that noted interaction on both did say that it was mainly on addenda.

There have been areas over the last decade where DPB has conducted studies that impacted funding decisions for base budget programs. For example, staffing studies conducted in the mid-1980s in the mental health and corrections areas were instrumental in base budget development for these agencies. However, this type of review is not done systematically. A file review of the working papers of DPB budget analysts who were assigned to case study agencies during 1990-92 budget development confirmed that the examination of base budget requests was primarily financial in nature and the outcomes of current programs were not routinely monitored or questioned. In addition, it appeared that there was little questioning of program goals and objectives.

DPB Has Outlined What a Programmatic Examination of the Base Should Include. While DPB appears to be conducting episodic programmatic examination of base budgets, the agency, in the early years of program budgeting, did outline what a systematic programmatic examination of base budgets should include. The *Commonwealth Planning and Budgeting System Manual*, developed by DPB in the late 1970s, outlined objectives and strategies for base budget review. The manual states that agency budget requests should be reviewed for "program objectives and performance records" and that "six basic questions must be answered." The six questions are: "(1) does a need exist; (2) how can the need be addressed; (3) what is the best way to address the need; (4) how much will it cost to address the need; (5) how will the costs be financed; and (6) what is the priority relative to other needs?"

The *1985 DPB Evaluation Section Handbook* further outlined what DPB evaluation of base budgets should do. It states that "the analyses undertaken [should] address three key questions (1) are current policies and programs appropriate and necessary government concerns; (2) are there alternative policies, programs, and activities or approaches to management and organization which would be more appropriate; and (3) are services providing results envisioned when they were established?"

Further, professional literature also provides insight into what an examination of base budgets should include. It states that base budget review should be focused on determining duplication of services, gathering reliable information that outlines the effectiveness of programs, determining if the most efficient processes are being used to deliver the programs, and determining whether the programs are still necessary. For DPB to effectively evaluate base budgets, such a systematic approach is needed.

Recommendation (2). **The Director of the Department of Planning and Budget should develop an appropriate methodology for programmatic examination of base budgets. Programs could be targeted for review in each biennial budget cycle, in consultation with the Governor's secretaries and House Appropriations and Senate Finance committees. Further, the Director of the Department of Planning and Budget should develop a training program for budget analysts on the methodology for programmatic examination of base budgets.**

RELATIONSHIP BETWEEN REVENUE ESTIMATES AND BUDGET DEVELOPMENT

Revenue forecasting is a critical component of State budget development because the Governor is required to submit a balanced budget to the General Assembly. There is a clear and direct relationship between general fund revenues and budgeted amounts. This relationship was best illustrated by recent budget reductions, when for every declining revenue forecast, there was a direct budgetary response. The recent interim forecast, first recommended in the JLARC report, *Revenue Forecasting in the Executive Branch: Process and Models*, has improved knowledge of the forecast's impact on budget development.

Nearly 52 percent of the revenues generated by the State were from nongeneral fund sources for the 1990-92 biennium. The relationship between the estimates for these funds and budgeted amounts is not as direct as that for general funds. In fiscal year (FY) 1991, the difference between the statewide amount estimated and that collected was more than $477 million.

Relationship Between General Fund Revenue Estimates and the Budget is Clear

The general fund revenue forecast is closely related to budget development from the time DPB begins to formulate the Governor's budget (during the fall) until the budget bill is submitted to the General Assembly in January. Throughout the budget development process, DPB receives informal updates of the State's revenue position from the

Department of Taxation. These updates typically do not include a fixed revenue point estimate, but include a range that will most likely include actual revenue collections. The Department of Accounts (DOA) also forwards revenue collection updates to DPB on a monthly basis. In addition, DPB staff attend all meetings of the Governor's economic and revenue-related advisory board meetings.

An example of how this has worked in the past was explained by the DPB deputy director for budgeting.

> *During Governor Baliles' administration, DPB staff developed scenarios concerning agency addenda requests. They would prioritize each addenda request as to whether it was a "must do," "should do," "could do," or "who cares" addenda.*
>
> *Then, when DPB was informed of the Governor's December 15 revenue forecast in early to mid-December, they would recommend to the Governor the addenda that were "must do's" for funding. If the forecast indicated that revenues were still available after these addenda were funded, DPB staff would recommend the "should do's" and so forth until most of the forecast was earmarked for base budgets or addenda requests.*

Declining revenues have not previously been a factor during agency base budget development. However, the best way to determine if the relationship is clear is to determine if timely budget reactions were made to adjust to declining FY 1990 and FY 1991 general fund revenue forecasts. JLARC's examination of the executive branch's budgetary responses to the declining forecasts of fiscal years 1990 and 1991 show that budgetary responses to changing general fund revenue forecasts have been timely.

The Interim Forecast Could Improve Knowledge of the Relationship Between Forecasts and Base Budgets

Based in part on JLARC's recommendation, Part Four, Section 4-1.04(a)(4) of the 1991 Appropriation Act now states:

> During the period the General Assembly is not in regular or special Session . . . the Governor shall take no action to reduce general fund expenditures or reduce allotments of appropriations on account of reduced revenues, until such time as a formal written re-estimate of general fund revenues for the current biennium prepared in accordance with the process specified in Section 2.1-393, *Code of Virginia* has been reported to the Chairmen of Senate Finance, House Finance, and House Appropriations Committees.

In accordance with the intent of this section and Item 766.3 of the Act, Governor Wilder presented an interim forecast on August 23, 1991.

The DPB deputy director for budgeting has indicated that the interim forecast did not necessarily provide DPB, the secretaries, or the Governor with more revenue information. According to the deputy director, the Department of Taxation traditionally provides DPB with a technical update of the revenue forecast each year in September after updated personal income figures are released.

However, the interim revenue forecast did provide the General Assembly, State agencies, and the public access to revenue information that would otherwise not have been available to them. The fact that a formal re-estimation was required ensured that revenue information was shared openly at a time when State agencies were uncertain about additional budget reductions for the current fiscal year. The majority of the case study agencies indicated that the information from the interim forecast was beneficial (seven of 11 agencies).

The interim forecast, however, appears to be of limited use to agencies in 1992-94 budget development, since the Appropriation Act only required the forecast to be of the current fiscal year. Therefore, it only indicated to agencies that as of August 1991 no further budget reductions would be necessary for FY 1992, but did not provide them with an outlook for the upcoming biennium. It would have been more helpful if an update of the revenue forecast for the upcoming biennium had been required. This would have ensured maximum utilization of the State's forecast effort and facilitated planning by the General Assembly and State agencies during times of reduced revenues.

Recommendation (3). **The General Assembly may wish to amend Part Four, Section 4-1.04(a)(4) of the Appropriation Act to require a formal re-estimation of general fund revenues for the current and next biennia.**

Estimating Nongeneral Funds Varies Throughout the State

Estimating revenues is not an exact science. Unlike the general fund forecast, there is no model that will allow a central executive branch agency to estimate all of the State's nongeneral fund revenues. Therefore, as part of budget development, agencies are required to annually estimate the amounts and sources of all nongeneral fund revenues they anticipate receiving. These estimates can vary significantly from actual collections. The statewide FY 1991 nongeneral fund estimate was more than $6.5 billion while actual collections were more than $7 billion — a seven percent difference of approximately $477 million (Table 4). In FY 1990, this difference was more than $435 million and, in FY 1989, it was approximately $103 million.

The differences in part can be attributed to varying estimating practices used by State agencies. Examples of the difference between estimates and collections for case study agencies are shown in Table 5. For example, according to the 1989 Appropriation Act, the Department of Rehabilitative Services (DRS) estimated that it would receive more than $45.7 million in nongeneral fund revenues for FY 1990 programs. However, the department actually received more than $50.8 million.

Table 4

Comparison of Statewide Nongeneral Fund Estimates and Collections

	FY 1989	FY 1990	FY 1991
Amount Estimated	$5,780,055,163	$5,884,930,460	$6,545,149,213
Amount Collected	5,883,972,964	6,320,131,182	7,022,469,976
Difference	$ 103,917,801	$ 435,200,722	$ 477,320,763
Percent Difference	2%	7%	7%

Source: JLARC analysis of 1988, 1989, and 1990 Appropriation Acts and Commonwealth Accounting and Reporting System (CARS) Report Trial Balance of General Ledger Accounts for FY 1989 through FY 1991.

Table 5

Selected Examples of Variations in Nongeneral Fund Estimates and Collections (Fiscal Year 1990)

Agency*	Amount Estimated	Amount Collected	Amount of Difference	Percentage Difference
APC	$ 3,015,706	$ 2,420,230	($ 595,476)	(19.8%)
DED	677,000	1,112,053	453,053	66.9
DOE	10,949,900	12,585,861	1,635,961	14.9
DMHMRSAS	16,570,700	4,417,097	(12,153,603)	(73.3)
DRS	45,729,967	50,846,032	5,116,065	11.2
ODU	53,152,280	56,111,558	2,959,278	5.6

* APC — Department of Air Pollution Control; DED — Department of Economic Development; DOE — Department of Education; DMHMRSAS — Department of Mental Health, Mental Retardation, and Substance Abuse Services; DRS – Department of Rehabilitative Services; and ODU — Old Dominion University.

Source: JLARC analysis of 1989 Appropriation Act and CARS Detail Net Revenue Fund Reports for year ending June 30, 1990.

Conversely, the Department of Mental Health, Mental Retardation, and Substance Abuse Services estimated that it would collect more than $16.5 million in nongeneral funds during FY 1990. However, the agency only collected $4.4 million, a negative difference of more than $12.1 million.

Part of this difference can be attributed to the different estimating practices used by agencies. Some case study agencies stated that they were conservative in making their nongeneral fund estimates because they wanted to maximize the amount of general funds they were appropriated. Other agencies purposely overestimated their nongeneral funds so they would not have to gain DPB approval for spending any additional funds they may receive during a fiscal year. Others overestimated in order to obtain matching general funds.

DPB Is Not Systematically Reviewing and Verifying Nongeneral Fund Estimates

Part Four, Section 4.1-05 of the Appropriation Act requires DPB to review and verify the accuracy of agency nongeneral fund estimates as part of budget development. Five of the nine DPB budget analysts whose case study agencies estimated nongeneral funds stated during interviews that they did not evaluate the accuracy of, or the methodology used by, their assigned agencies to estimate nongeneral funds. The DPB deputy director for budgeting stated that time restrictions prevent a thorough analysis of all nongeneral fund sources and estimates by DPB budget analysts.

Further, all but one of the DPB analysts asked indicated that they did not review agency nongeneral fund revenue reports and compare them to the agency's estimates during the fiscal year. Because DPB is not systematically evaluating the accuracy of the estimates, executive branch accountability concerning nongeneral funds is lessened. The General Assembly also may not be receiving the best information possible on which to make budgetary decisions. One result is that budgetary control may be lost by the legislature.

Recommendation (4). **The Director of the Department of Planning and Budget should comply with Part Four, Section 4.1-05 of the Appropriation Act by ensuring that the accuracy of all agency nongeneral fund revenue estimates are routinely reviewed and evaluated.**

There Are Problems in Comparing Estimates and Collections Because of the Way Data Are Collected

JLARC staff could not easily estimate variances in the nongeneral fund estimates and collections at the agency level because of the way revenue information is collected and reported on the Commonwealth's Accounting and Reporting System. For example, *Unclaimed property receipts provide the Department of the Treasury with nongeneral funding each year for administering the unclaimed property program. The remaining amount, net of claims, is transferred to the Literary Fund. For FY 1990, the Appropriation Act amount for the department was approximately $1.6 million, the amount necessary for the department to administer the program. The CARS year-end net revenue fund report for the department, however, indicates that the department received approximately $14.6 million in revenue — a difference of 819 percent. This amount was the total collected from unclaimed property receipts — both the amounts needed for administering the program and that going into the Literary Fund.*

* * *

The Department of Fire Programs is funded through an assessment on licensed insurance companies collected by the State Corporation Commission. For FY 1990, the Appropriation Act estimate for the department was approximately $10.3 million. The CARS year-end net revenue fund report indicates that the department received only $97,604 in revenues for the year. According to the fiscal director of the department, the revenue collected from the insurance companies is treated as a transfer instead of revenue.

This information is necessary so that legislative and executive budget officials can have access to accurate information on the differences in nongeneral funds estimated by agencies and those actually collected. The Department of Accounts and the Department of Planning and Budget have a task force which was established to resolve such problems.

Recommendation (5). **The Department of Accounts and the Department of Planning and Budget through the DOA-DPB Task Force should examine ways to improve the reporting of nongeneral fund revenues to ensure that accurate comparisons of agency estimates against collections can be made. The Director of the Department of Planning and Budget and the State Comptroller should report the findings of this examination to the House Appropriations and Senate Finance committees prior to the 1993 General Assembly.**

III. Budget Execution

Once monies have been appropriated by the General Assembly, the execution phase of the budget process begins. Budget execution is the implementation of policies and expenditure of funds in accordance with the budget enacted by the General Assembly. Execution is the responsibility of the Governor, central agencies, and line agencies. A sound budget execution process should allow executive branch officials enough flexibility to react to changed circumstances or unforeseen events, yet apply adequate controls to ensure that legislative intent regarding the types and levels of expenditures is followed. This chapter examines the adequacy of executive branch discretion in budget execution and assesses incentives for good financial management by agencies.

FLEXIBILITY IN BUDGET EXECUTION IS GENERALLY APPROPRIATE

The *Code of Virginia* (Section 2.1-387) authorizes the Governor to be "the chief planning and budget officer of the Commonwealth." Consistent with this statute, the executive branch has been given considerable flexibility to react to budgetary changes required after the Appropriation Act has been enacted. JLARC staff's examination of these budget execution activities indicates that legislative intent has been followed in most areas and, in general, the amount of flexibility granted by the General Assembly is warranted.

Governor Has Been Granted Considerable Flexibility for Budget Execution

The Appropriation Act specifies that the Governor may withhold, increase, or transfer appropriations within some limitations. The Governor is also authorized to approve deficit financing for State agencies. In addition, the Governor can withhold allotments in the event general fund revenue forecasts are not met. This is consistent with the Governor's power to "ensure that no expenses be incurred which exceed total revenues on hand and anticipated" conferred in Article X, Section 7 of the *Constitution of Virginia*.

Authority to Withhold Funds. The 1991 Appropriation Act gives the Governor authority to withhold funds when program evaluations conclude that expenditures are not warranted or when client service or workload levels of appropriated amounts differ from the ones used to set appropriations. The 1991 Appropriation Act, however, limits total reductions in any agency to 15 percent of their total appropriation. The Governor can also withhold general fund appropriations in agencies if nongeneral fund revenues exceed the agency estimates.

Authority to Increase Appropriations. The Governor also has been granted authority to increase appropriations. According to the 1991 Appropriation Act, the Governor can reappropriate and reallocate general fund appropriations not expended at the end of the first fiscal year (FY) into the second year of a biennium. Under certain conditions, unexpended nongeneral fund appropriations may be reappropriated and allocated from one fiscal year to the next.

The Department of Planning and Budget (DPB) can transfer appropriations from the second year to the first for an agency under certain circumstances. DPB's director can also authorize increases to an agency's appropriation when additional nongeneral fund revenues are received from the sale of surplus property, insurance recovery, gifts, grants, donations, and other sources of nongeneral fund revenues.

Authority to Transfer Appropriations. The executive branch also has the authority to transfer both funding and positions, within certain constraints delineated by the legislature, granted to it in the Appropriation Act. The Act gives the Director of DPB authority to transfer appropriations within a State agency or between agencies "for a closely and definitely related purpose." The 1991 General Assembly limited this authority to 15 percent of the appropriation. The 1991 Appropriation Act specifies that the director must first "determine that the transfer effects the original intention of the General Assembly in making the appropriations."

Authority to Approve Deficit Funding. Finally, Part Four of the Appropriation Act authorizes the Governor to approve deficit funding for agencies that meet one of three conditions. These conditions are (1) an unanticipated federal or legal mandate is imposed; (2) sufficient funds are unavailable in the first year of a biennium to begin a General Assembly-approved action; or (3) a delay in action may result in a substantial increase in cost or lost benefit (again, for a legislatively approved activity). However, the Act does not allow authorized deficits for capital projects or if the problem could have been "foreseen while the General Assembly was in session."

In One Case, Governor's Actions to Withhold Appropriations During Recent Budget Reductions May Have Violated Legislative Intent

During FY 1990 and FY 1991, legislators raised concerns that the Governor's withholding of appropriations from the Department of World Trade may have violated legislative intent. Based upon review of the *Constitution of Virginia*, the *Code of Virginia*, the 1990 Appropriation Act, and opinions of the Attorney General, JLARC staff could not locate any specific legal basis for the Governor's closing of the department by withholding all appropriations to it. The Governor, on the other hand, has cited the authority in the Appropriation Act that states funds can be withheld from agencies based on program evaluations.

In the 1991 Session, the General Assembly curtailed some of the Governor's authority to withhold appropriations, partly in response to the Governor's action concerning the Department of World Trade. Key changes in the 1991 Appropriation Act (Chapter 723) effecting this authority are listed in Exhibit 3.

These changes appear to appropriately clarify legislative intent in this area. The Governor has stated, however, that he views the change prohibiting the withholding of funds until General Assembly approval of reorganization plans as unconstitutional. None of the participants in the dispute have sought legal remedy, so a final resolution of the difference appears unlikely at this time.

Executive Branch Appropriation Transfers Largely Comply With Legislative Intent

Once the General Assembly appropriates monies, the executive branch allots the amount of funds available for spending by each State agency. Some differences between the spending authority granted agencies by the General Assembly (the appropriation) versus the spending authority granted by the executive branch (the allotment) are to be expected. (See Exhibit 4 for definitions of these terms.)

It appears that the executive branch generally complies with legislative intent when transferring appropriations. Further, the changes made to the Governor's transfer authority during the 1991 General Assembly Session appear to be ineffective in limiting this authority, if that was the intent.

Exhibit 3

Additional Limits On Governor's Authority to Withhold Appropriations Adopted in 1991 Appropriation Act (Chapter 723)

Removed the Governor's authority to withhold funds for expenditure based on a finding that the appropriation is in excess of the amount necessary for the purpose.

Revises the authority of the Governor to withhold appropriations based on program evaluations or input factors. Act also specifies 15 percent limitation, a written program evaluation, and 45 days notification of the proposed withholding.

Prohibits withholding of funds based on reorganization plans until such plans have been approved by an act of the General Assembly or in accordance with Section 2.1-8.3 et. al. of the *Code of Virginia*.

Source: JLARC analysis of 1990 Appropriation Act (Chapter 972) and 1991 Appropriation Act (Chapter 723).

Exhibit 4

Definitions of Terms Used in Budget Execution

Appropriation:	The authority granted by the General Assembly to make expenditures and incur obligations for a specific purpose.
Allotment:	The portion of an appropriation which is made available to an agency for expenditure or encumbrance during the fiscal year by the executive branch.

Source: JLARC analysis of professional literature and the *Commonwealth Planning and Budget System Manual.*

Some Variation is to be Expected in Agencies. Some variation should be expected simply because the Appropriation Act amount listed in Part One of the Appropriation Act for each agency (the agency total) does not reflect additional funds appropriated to an agency by the General Assembly in other parts of the Act. For instance, a central account in Part One of the Act may contain appropriations that the General Assembly designated for distribution to agencies for salary regrades. The Appropriation Act may also include language to reduce State agency appropriations. DPB is responsible for calculating and allotting these individual amounts to each State agency. This amount would therefore be an addition or subtraction to the total agency amount listed in Part One of the Act as the example shown in Table 6 illustrates.

Variation Between Appropriations and Allotments Was Examined. For the FY 1990 total operating budget, the variation in the funding initially appropriated to State agencies and the final amount allotted to them totalled more than $1.2 billion (Table 7). To determine if this variation was consistent with legislative intent and that all transfers were accounted for, JLARC staff examined the transfers of appropriations for FY 1989 and FY 1990 in 88 State agencies that had a great deal of variation between their initial appropriation and their final allotment. More than 1,900 transfers, totalling more than $321 million, were examined.

Overall, executive branch appropriation transfers were consistent with legislative intent as expressed in the Appropriation Act and transfers did account for the difference between appropriations and allotments in all agencies. An examination of transfers in these agencies show that the majority of transfers are for technical — not policy — reasons. When DPB analysts do have a question regarding whether a transfer would be consistent with legislative intent, they frequently ask staff of the House Appropriations and Senate Finance committees for advice and guidance. Only one transfer was found to be inconsistent with legislative intent. The transfer appears to have violated Appropriation Act language and may have masked a program deficit. This transfer (for $60,028) accounted for less than two-tenths of one percent of the dollar amount of those examined.

Table 6

Example of the Difference between an Agency's Appropriation and Its Allotment (Fiscal Year 1990) (Using the Department of Youth and Family Services)

	Total Amount of Funding
Appropriation Listed in Part One of Act (agency total)	$89,252,152
Total Appropriation Authority Granted in the Act	$95,359,138
Difference in Part One and Total Authority	$ 6,106,986
Percentage Difference	6.8%
Allotment to Department by DPB	$96,903,550
Difference in Allotment and Part One	$ 7,651,398
Percentage Difference	8.6%
Difference in Allotment and Total Authority	$ 1,544,412
Percentage Difference	1.6%

Source: JLARC analysis of Program Budgeting System (PROBUD) data.

Table 7

Difference Between Appropriations and Allotments (Total Operating Budget) for FY 1989 and FY 1990

	FY 1989	FY 1990
Appropriation Act*	$11,383,357,205	$11,836,496,890
Allotments	12,250,478,335	13,053,433,564
Difference between Act and Allotment	$ 867,121,130	$ 1,216,936,674

*Includes all monies appropriated by General Assembly.

Source: JLARC analysis of PROBUD data.

Changes Made to Transfer Authority Appear to be Ineffective. In the 1991 Session, the legislature limited executive branch authority to transfer appropriations "for a closely and definitely related purpose" to 15 percent of the appropriation. The 15 percent limitation on transfers has not been effective in limiting the executive branch's transfer authority, if that was the intent. As a July 1, 1991, memorandum to DPB budget analysts from their director notes, the authority exists for the transfer of a large appropriation in a series of 15 percent increments. In addition, none of the DPB budget section managers interviewed believed that the 15 percent limitation would have an impact on the State agencies in their assigned secretariats.

A re-examination of transfer activity in the 44 agencies for both FY 1989 and FY 1990 revealed that only systems of agencies (the Department of Corrections; the Department of Mental Health, Mental Retardation, and Substance Abuse Services; and the Virginia Community College System) would have been impacted by the 15 percent limitation if it had been in effect. Most of the transfers in systems are for technical reasons.

In addition, "a closely and definitely related purpose" can be subject to interpretation. As one DPB budget analyst stated during an interview, "a closely and definitely related purpose has been interpreted as anything within the same functional area of State government." Therefore, the 15 percent limitation does not appear to have an effect on possible policy decisions made by the executive branch. It appears that the limitation may impair technical adjustments that are necessary during budget execution.

Recommendation (6). **The General Assembly may wish to consider amending Part Four, Section 4-1.03(a)(1)(a) of the Appropriation Act to delete the language "up to 15 percent" or strengthen the language to effectively restrict transfers if that was the original intent.**

Reporting of Nongeneral Fund Appropriation Increases Needs to Be Improved

Accurate budgetary information is essential for legislative oversight, particularly when additional nongeneral funds are received for creation of new programs. It is also essential for accurate accounting of all nongeneral funds flowing into the State. Significant amounts of additional nongeneral fund revenues are routinely received by agencies during the fiscal year. (Problems with estimating these funds were discussed previously in Chapter II of this report.)

In FY 1991, an additional $477 million in nongeneral funds over the estimate were received. If agencies receive additional nongeneral funds that exceed the amount specified in the Appropriation Act, they must request that their appropriation be increased and have the request approved by DPB. Interviews with DPB analysts confirmed that these requests are rarely denied.

Historically, it has been difficult to estimate or even determine the total amount of additional funds coming into the State, particularly at the agency level. JLARC staff reviewed appropriation increase requests for five of the 11 case study agencies who reported the receipt of additional nongeneral funds during FY 1989 and FY 1990 (Table 8). More than $24 million in additional nongeneral funds were received by these five agencies during the two-year period.

Because these additional funds are collected during the fiscal year, the General Assembly may not be aware that they were received or spent by agencies. Most additional funds are received for approved programs. In some cases, however, these additional funds can be for new programs, as the following examples illustrate.

During FY 1990, the Department of Rehabilitative Services received more than $1.1 million from the federal government for a new program in assistive technology.

* * *

During FY 1989, the Department of Mental Health, Mental Retardation, and Substance Abuse Services received more than $800,000 from the federal government for a homeless persons demonstration project.

Table 8

Additional Nongeneral Funds Received by Selected Case Study Agencies* (Fiscal Years 1989 and 1990)

Agency	Additional Nongeneral Funds Received During Fiscal Year FY 1989	FY 1990
Department of Corrections	$ 0	$ 147,590
Department of Mental Health, Mental Retardation, and Substance Abuse Services	$ 3,557,234	$3,286,884
Department of Rehabilitative Services	$ 9,071,021	$5,283,282
Old Dominion University	$ 1,920,503	$ 648,216
Virginia Department of Transportation**	$ 248,000	$ 0
TOTAL	$14,796,758	$9,365,972

*Funds beyond the amount specified in the Appropriation Act.
**Does not include bond or toll proceeds.

Source: JLARC analysis of case study agency and DPB data.

Statewide figures on the additional amounts of nongeneral funds allocated to agencies have not been readily available. With DPB's recent conversion to the Form 27/27A Automated Transaction System, a statewide amount could be determined and transmitted to the General Assembly at the end of the current fiscal year using this automated system.

Recommendation (7). **The General Assembly may wish to consider amending Part Four, Section 4-8.01 of the Appropriation Act to require the Governor to report annually on the receipt of additional nongeneral funds, their sources, and the amounts for all State agencies. In addition for the 1994 Session of the General Assembly, the Department of Planning and Budget and the Department of Accounts should conduct a study to identify sources of nongeneral fund revenue that might more appropriately be included in the general fund.**

CENTRAL CONTROLS PROVIDE ADEQUATE SAFEGUARDS

DPB and the Department of Accounts (DOA) both have significant responsibilities for ensuring that legislative and gubernatorial intent is followed during the expenditure of State funds by agencies. Consistent with their responsibility, both DOA and DPB place financial controls on agencies. While there are some weaknesses in central controls, for the most part, they have been recognized and are being addressed. Overall, the central controls do supply adequate assurance that legislative intent regarding expenditures is carried out.

Central Financial Controls Appear Adequate

The Department of Accounts is responsible for overseeing the expenditure of State funds and the movement of cash into, and out of, the State treasury. DPB is responsible for controlling appropriations and allotments. Both agencies ensure that State laws, policies, and procedures are followed by State agencies during budget execution.

DOA authorizes the payment of all bills owed by State agencies. Before these bills are authorized, DOA staff review the bills and payment vouchers to ensure that State policies and procedures have been followed during the expenditure. Every State agency has some of its payment vouchers reviewed by DOA. DOA reviews the agencies on a rotating basis so each agency's vouchers are examined during four, two-week periods during a fiscal year and are otherwise examined on a sample basis. DOA also reviews all travel vouchers. In some cases, these audits reveal that State funds are not being expended appropriately.

A higher education institution submitted a voucher to DOA to pay for a trip to an out-of-state theme park for 33 underprivileged children. The *institution included an "excellent rationale" for why State funds should be used to pay for the trip, according to the assistant comptroller. However, when the assistant comptroller reviewed the list of children, he recognized some last names on the list. Upon further research, DOA found that many of the 33 children were those of professors, former presidents, or other high-level staff of the institution. The payment was denied.*

* * *

Another agency requested permission to pay for the air fare of an employee's spouse. The agency has a policy of not requiring its employees to stay away from home for more than two weeks even if the assignment requires additional time. The employee agreed to stay three weeks to complete the assignment if the agency would pay to fly the spouse to visit. Therefore, the agency wanted to fly the spouse to the site of the assignment. DOA notified the agency that payment for the spouse's air fare would violate State travel regulations.

State agencies, DOA, and DPB all identified areas in which central controls could be improved. In most cases, improvements are either under way or are being planned. Further, there do not appear to be areas in which further improvements to central controls are necessary to ensure the appropriate expenditure of State funds.

Some Controls Could be Further Loosened

Central controls have been relaxed by the General Assembly for selected agencies. These areas include the decentralization of public records in two higher education institutions and the control of transfers between agencies within systems. Decentralization of records could be expanded to additional agencies. Controls over transfers within systems of agencies, despite legislative approval, have not been loosened by the executive branch. In addition, Section 2.1-224 of the *Code of Virginia* should be amended to end the requirement for quarterly allotments.

Decentralization of Financial Records Succeeding Where Used. The General Assembly in the 1991 Appropriation Act authorized the decentralization of public records in two pilot agencies — Virginia Polytechnic and State University and the University of Virginia. This decentralization allows DOA to delegate to these agencies responsibility for retention of certain financial documents, including all back-up materials for payment vouchers. The intent as stated in the Act is "to foster institutional flexibility and reduce processing costs." The General Assembly has asked that an evaluation of the pilot program include "an assessment of additional opportunities for further delegation of central accounting functions with the objective of realizing greater operational efficiencies in this area."

Both the Auditor of Public Accounts (APA) and comptroller have stated that the pilot is succeeding. DOA staff have indicated that successful expansion of decentralization will reduce their workload, lessen the amount of duplication between agencies and DOA, free up storage space, and reduce their operating costs. The comptroller would like other agencies granted the same privilege and case study agencies have expressed interest in having this responsibility.

Control of Transfers Between Agencies Within Systems Needs to be Lessened. Currently, fiscal staff of systems of agencies and the DPB budget analysts assigned to them must spend time and resources on simple, technical adjustments. The General Assembly in the 1990 Appropriation Act (Chapter 972) granted systems of agencies the authority to make appropriation transfers without DPB's prior approval. However, DPB has not yet promulgated the written guidelines to implement this activity as required by the Appropriation Act.

In Chapter V of this report, JLARC staff recommend one agency code for systems in the operating budget, which would end the problem of transfers in systems of agencies. However, in the event that recommendation is not adopted, DPB should promulgate the written guidelines called for in the Appropriation Act. This would reduce the unnecessary work required in budget execution for the systems of agencies.

Recommendation (8). **If there is not one agency code designated for systems of agencies in the Appropriation Act, the Director of the Department of Planning and Budget should promulgate the written guidelines that would allow systems of agencies to make operating budget appropriation transfers without DPB's prior approval.**

Quarterly Allotment Requirement Should be Deleted from Code of Virginia. Section 2.1-224 of the *Code of Virginia* states that no agency's appropriation can be allotted for expenditure "until the agency shall submit to the Director of the Department of Planning and Budget quarterly estimates of the amount required for each activity to be carried on, and such estimates shall have been approved by the Governor." This requirement is no longer used by the executive branch because automation and program budgeting have made it unnecessary. Agencies are typically allotted funds for expenditure on an annual basis, at the beginning of a fiscal year.

Case study agencies, whose budget personnel were with the agency when quarterly allotments were required, noted the extra paperwork and the time their use required. The DPB deputy director for budgeting and the comptroller both noted that the quarterly allotments no longer served a necessary purpose since expenditures can be reconciled and monitored on the Commonwealth's Accounting and Reporting System by agencies on a daily basis. In addition, the comptroller requires agencies to reconcile their internal accounting records with those of DOA on a monthly basis.

According to a 1989 National Association of State Budget Officers study, 24 states do use a quarterly allotment system to control agency expenditures. However, the majority of these states do not use program or incremental budgeting. They use either line-item or lump-sum budgeting.

Requiring the executive branch to return to quarterly allotments would burden agencies, DPB, and DOA with little benefit. It would also require additional time by DPB analysts on execution duties, already 25 percent of their time. Agencies' fiscal staff would have additional work, as would DOA staff. Therefore, the current practice of annual allotments should be continued and the *Code of Virginia* amended to reflect current practice.

Recommendation (9). **The General Assembly may wish to consider amending Section 2.1-224 of the *Code of Virginia* to reflect the current practice of annual allotments. The requirement for quarterly allotments and estimates should be deleted.**

AGENCY FINANCIAL MANAGEMENT APPEARS SOUND

According to Section 2.1-20.01:1 of the *Code of Virginia*, agency directors are "to be responsible for all expenditures pursuant to appropriations." This responsibility was further reiterated by the Hopkins Commission when it recommended the concept of decentralized financial management in the mid-1970s.

During Governor Robb's term (1982-86), agency financial accountability and decentralization were again emphasized and a formal evaluation system was instituted for agency directors, including evaluation of their financial management. During Governor Baliles' term (1986-90), financial management standards were recommended for implementation in all State agencies by the Governor and authorized by the General Assembly. These financial management standards were only implemented for the institutions of higher education. In addition, agency directors continued to be formally evaluated by the Governor's secretaries. Some agency directors are being evaluated on their financial management during this administration, and this type of evaluation should be applied to all directors.

As a result of the financial management standards, institutions of higher education receive an additional financial benefit from practicing good financial management that other State agencies do not receive. One result has been that some agencies see little incentive to conserve funds that will ultimately revert to the State treasury at the end of the fiscal year. In FY 1991, DPB notified agencies that they would be allowed to carry-forward their unexpended general fund balances, as a one-time measure. According to DOA, this one-time incentive was used to help build end-of-year cash balances. Many agencies changed their spending practices to take advantage of the carry-forward. Financial management standards and incentives should be implemented for all State agencies.

Agency Financial Management Is Generally Sound

The responsibility for good financial management rests with agency directors. In general, this review found that agency financial management is sound and State funds are spent appropriately. Agencies have internal financial controls to help ensure that they practice sound financial management. In addition, agencies appear to carefully monitor their expenditures and there do not appear to be common financial management problems.

Internal Controls are Generally in Place Within Agencies. The comptroller requires that State agencies have internal financial controls in place. Of the 11 case study agencies, nine had policies and procedures in place to control the expenditure of funds. The two that did not were the Department of Education and the Department of Economic Development. JLARC and the APA have recently outlined the results of the lack of internal controls in these agencies.

> *During the 1990 review of the Department of Economic Development, JLARC staff found instances in which funds were spent out of incorrect program appropriations. For example, the Software Productivity Consortium (SPC) was paid $8,444 from the industrial development services program appropriation. The Appropriation Act specifies that payments to the SPC are to be made from the administrative and support services program appropriation.*
>
> * * *
>
> *During the FY 1990 APA audit of the Department of Education, violations of State procurement laws were found. These included letting contracts for more than $660,000 without asking for bids and entering into a $536,000 contract to buy future software, which violates both the Appropriation Act and State procurement laws that require competitive procurement.*

Both of these agencies are currently in the process of developing appropriate policies and procedures to control the expenditure of funds.

During interviews, case study agencies were asked if there were any areas in which their internal financial controls needed improvements. Six of the 11 indicated that there were. These areas included payroll, fixed assets, grants, contract administration, and federal grant cash management. Agencies appear to be aware of their financial management weaknesses and are working toward correcting them. As one agency stated:

> While internal controls and financial management policies and procedures are in place and understood by our fiscal staff, they need to be personalized for agency-wide use. Our role to agency staff is the same as DOA's is to us. We need to provide them training and understanding of what is required of them to ensure sound financial management.

Agencies Appear to Closely Monitor Their Expenditures. The case study agencies were asked during interviews how they monitor their expenditures. All agencies are required to reconcile their internal accounting records with those of DOA on a monthly basis. In addition, the 11 agencies conducted budgeted versus expended analyses at least on a monthly basis. This monitoring was done at the cost center or line-item level within the agency and necessary actions were taken to correct any problems as the following examples illustrate.

> *The Department of Mental Health, Mental Retardation, and Substance Abuse Services central office budget staff review expenditures by all sections within the department on a monthly basis. If expenditures appear to be exceeding the budgeted amount or previous years' expenditures, a meeting is held to determine the cause and what corrective action is necessary.*
>
> * * *
>
> *At the beginning of each fiscal year, budget management guidelines are sent to all vice-presidents, deans, and department chairs at Old Dominion University. To ensure that these guidelines are met, monthly letters are sent if the university controller's monthly review indicates problems. If the staff do not correct their performance, the supervising vice-president is informed. If the vice-president does not correct the problem, the president is informed. In addition, staff are formally evaluated on their ability to manage their finances each year.*

<u>There Do Not Appear to Be Common Financial Management Problems within Agencies.</u> A review of the APA audit reports for the last five fiscal years for the 11 case study agencies revealed no common agency-based financial management problems. The two common audit points raised by APA staff were fixed assets and payroll. The APA has indicated that these concerns must first be addressed by DOA.

Uniformity Needed in Evaluating Financial Management Performance of Agency Directors

All agency heads should receive some formal feedback on their financial management performance. According to the case study agencies (with the exception of Old Dominion University) no formal evaluations of their directors have been completed during this administration. Presidents of higher education institutions are evaluated on their financial management by their boards of visitors. The secretaries of finance and health and human resources do have financial management goals and objectives for their agencies' directors.

Uniform evaluations of directors, including their financial management, have been done during past administrations. Because agency directors are not covered by the Virginia Personnel Act, there is no statutory requirement that agency directors be evaluated. Therefore, agency directors do not have to be evaluated on their financial management. To ensure continued sound financial management, the Governor's secretaries should develop a uniform mechanism for evaluating their agency directors on their financial management.

Recommendation (10). **The Secretary of Administration in conjunction with the Secretary of Finance should develop a uniform system for evaluating the financial management performance of agency directors.**

There Are Few Incentives for Sound Financial Management for Most Agencies

Since 1988, the Appropriation Act has authorized the use of management standards for all State agencies. Meeting these standards would allow agencies certain benefits, including carry-forward of unexpended funds. Without the benefit of these incentives, State agencies realizing financial savings by improving the efficiency of their operations have historically seen these savings revert to the general fund. The result has been that some State agencies, even in times of budget reductions, have maintained a "use it or lose it" philosophy of spending as much as possible before the end of a fiscal year. While there is anecdotal evidence of this activity, no State agency contacted during this review wanted to go "on record" and detail this activity.

Management Standards Are Not In Place For All State Agencies. Part Four, Section 4-1.06 of the Appropriation Act allows management standards to be prescribed by the Governor for all State agencies. However, the Governor has not prescribed these standards for all State agencies. Management standards for higher education have been used since 1988. These standards are as follows:

- an unqualified audit opinion by the APA;
- no significant audit deficiencies as attested to by the APA;
- compliance with financial reporting standards endorsed by the State Comptroller;
- attainment of accounts receivable standards; and
- attainment of accounts payable standard.

By meeting these standards, higher education institutions will receive the following benefits during the current fiscal year: (1) reappropriation of a portion of unexpended education and general fund balances; (2) retainment of 100 percent of the proceeds from the sale of surplus property; and (3) the ability to exceed the maximum employment level (provided that the 12-month average for the fiscal year does not exceed that level). According to DOA, the amount of funds that higher education institutions meeting these standards were authorized to carry-forward was approximately $825,000 in FY 1991 and $3.2 million in FY 1990. According to the Director of DPB and the Comptroller there is no reason why the standards could not be implemented for other State agencies, as the

General Assembly intended. If the higher education institutions' management standards were applied to all executive branch agencies for fiscal year 1990, it appears that 66 of 100 State agencies would have met these standards (Table 9).

Some Case Study Agencies Indicated that Financial Incentives Would Change Their Spending Patterns. As noted earlier, one result of the lack of incentives for State agencies has been that they are tempted to spend as much as possible at the end of the fiscal year. If money is saved by economies and efficiencies in one area, they might spend the money in another area to keep it from reverting at the end of the year and potentially from elimination from their base altogether. Ten of the 11 case study agencies do not typically have reversions at the end of a fiscal year, and if there is a reversion it is usually less than one percent. To benefit agencies, DPB notified agencies that unexpended balances would not be reverted to the general fund at the end of FY 1991. While the reasoning for this was to help the State build year-end fund balances in FY 1991, carry-forwards could be routinely used as an incentive for State agencies to practice better financial management. When asked if the benefits received from achieving the financial management standards would change their spending practices, eight of the 11 case study agencies answered that they would.

Financial Incentives the General Assembly May Wish to Consider. Case study agencies were asked what types of financial incentives would be appropriate. The incentives cited included being able to carry-forward a percentage of unexpended fund balances; allowing encumbrance of funds for specific purposes; and allowing reprogramming of base budgets. These incentives are similar to those already in place for higher education institutions and in other states.

Table 9

Application of Financial Management Standards to All State Agencies

Standard	Number of Agencies Who Met Standard
Unqualified audit opinion	79
No significant audit deficiencies	79
Compliance with financial reporting standards	81
Attainment of accounts receivable standard	66
Attainment of accounts payable standard	88
	N = 100

Source: JLARC analysis of APA and DOA data for FY 1990 and FY 1991.

State agencies which meet the standards could be allowed to carry-forward their unexpended balances up to two percent of their general fund appropriation, as the Appropriation Act currently allows. For FY 1992, agencies were able to carry-forward unexpended balances to help them address the budget reductions. Case study agencies viewed this as an incentive to save that could be continued.

Some case study agencies indicated that it is difficult to save large sums of dollars during one fiscal year for such purchases as computer equipment or other expensive items because of unexpected expenses. Seven of the 14 other states interviewed allow agencies to encumber funds between fiscal years. Six of the seven require these funds to be encumbered by agencies for specific purposes such as the purchasing of computer equipment. Several case study agencies also viewed the opportunity to reprogram their base, without fear of automatically losing base budget funding, as another financial incentive that could be considered.

Recommendation (11). **The General Assembly may wish to consider requiring the executive branch to implement the financial management standards that are currently outlined in Part Four, Section 4-1.06 of the 1991 Appropriation Act. In addition, the General Assembly may wish to consider allowing agencies the following incentive options: encumbrance of unexpended funds for specified purposes and the ability to keep a portion of funds from the reprogramming of their base budgets.**

Recommendation (12). **The Secretary of Finance should study additional incentives for sound financial management, especially for agencies with significant amounts of nongeneral funds. The Secretary should report his findings on these incentives to the House Appropriations and Senate Finance committees prior to the 1993 Session of the General Assembly.**

IV. Evaluation

While the amount of evaluation and the number of executive and legislative agencies conducting evaluations has increased since the mid-1970s, the number of formal program evaluations being conducted by the executive branch is still relatively limited. Because of seemingly limitless needs and finite resources, it is important that decisionmakers have objective information readily available to assist them in choosing between new or changing needs and established programs. In addition, established programs should be evaluated to ensure that they are operating as efficiently and effectively as possible.

The General Assembly, in adopting program budgeting, tried to ensure that these choices, and the evaluation needed to make them, would occur as part of the budget process. Formal legislative intent as stated in the *Code of Virginia* requires the Department of Planning and Budget (DPB) to evaluate agency programs to ensure their efficient and effective operations. Further, the *Code of Virginia* requires the establishment and monitoring of performance measures as part of the executive budget process.

In part because incremental budgeting is used, the majority of evaluations being conducted are financial assessments, policy analyses, or organization and management reviews. (These different types of evaluation are defined in Exhibit 5.) In addition, performance measures are not used in the majority of State agencies and their development for base budget programs is not currently required by the executive branch. However, the current Director of DPB is planning to develop performance measures with State agencies on a pilot basis. Legislators or their staff should be given the opportunity to participate in this effort.

EXECUTIVE BRANCH EVALUATION IS LIMITED

While DPB does conduct evaluation, the types of evaluation are generally financial assessment or policy analysis. For the most part, agency base budgets and the programs that comprise them are evaluated from a financial perspective by DPB budget analysts. In addition, the efforts of DPB's evaluation section have not focused ordinarily on program impact or effectiveness.

Some State agencies do conduct evaluations of the programs funded as part of their base budgets. During this biennium, additional agencies were forced to conduct program evaluations because of budget reductions. However, this information is typically not reported to budgetary decisionmakers, and there is no guarantee that evaluations would continue when revenues improve.

Exhibit 5

Definitions of Types of Evaluations

Financial assessment:	A systematic examination of actual or proposed financial transactions, made either before (pre-audit) or after (post-audit) their finalization.
Organization and management evaluation:	Studies and assistance to agencies on organization procedures and systems which result in recommendations for improving the efficiency and increasing the productivity of organization operations.
Performance evaluation:	The results of programs and expenditures are judged by whether or not they met expectations. Two important aspects of performance evaluation are the creation of criteria (performance measures) against which program results can be measured and the development of a system for collecting the needed data on program results.
Policy analysis:	The systematic study of the directives by which management delineates the overall direction of government activities within a specified functional area.
Program evaluation:	The systematic study of programs to define and/or review their goals and objectives, to determine the resources required, and to judge whether the programs are effective and are accomplishing their objectives.

Source: JLARC analysis of professional literature.

DPB does not currently require that performance measures be developed for programs included in agency base budgets. While some State agencies use performance measures as a management tool, the majority do not develop them or find them useful in budget development or evaluation.

Evaluation by DPB Budget Analysts Has Budgetary Impact, But Little of It Focuses on Programs

In 1975, the General Assembly adopted program budgeting, putting in place a mechanism for evaluation of State programs. At the same time, the General Assembly established the Department of Planning and Budget and charged it with evaluation duties.

Section 2.1-391 of the *Code of Virginia* details several evaluation duties for DPB. These include the following:

- developing and directing an integrated policy analysis, planning, and budgeting process;
- conducting policy and program analysis for the Governor;
- continuously reviewing the activities of State government, focusing on budget requirements in the context of the goals and objectives set by the Governor and General Assembly; and
- monitoring the progress of agencies in achieving the goals and objectives.

Evaluation is an on-going activity in DPB's five budget sections. The evaluation that does occur appears to be financial or policy analysis in nature. For example, DPB budget analysts recalculate agency base budget personal services requests. For addenda, on which the majority of evaluation emphasis is placed during budget development, the evaluation may include both financial and policy evaluation. These evaluations are professionally done and have a budgetary impact. However, DPB budget analysts are not typically or regularly examining the efficiency or effectiveness of base budget programs. This is evident in three ways.

First, the average percentage of time 10 DPB budget analysts assigned to the case study agencies spent on program evaluation was eight percent (Figure 2). Second, the standard position descriptions for two of the three professional levels of budget analysts do not include program evaluation as a chief objective of an analyst. Third, DPB budget analysts typically are not assigned to the same agencies through one entire biennial budget cycle. Consequently, limited time is available for analysts to develop knowledge of agency programs. Therefore, analysts' ability to evaluate program efficiency and effectiveness is limited. (Concerns about the continuity of DPB analysts assigned to State agencies will be discussed further in Chapter VI.)

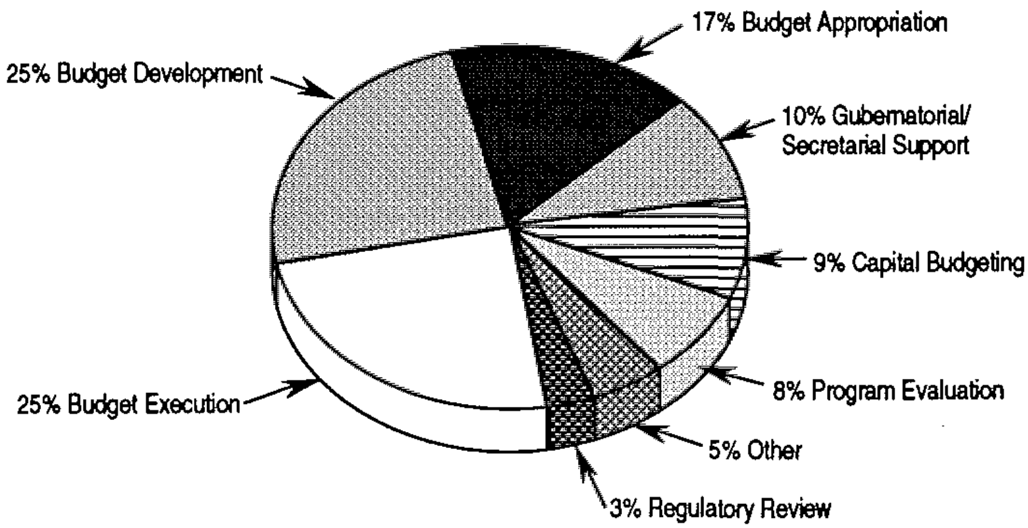
Recently, DPB has made changes that would reduce the amount of time budget analysts spend on execution activities. Consequently, DPB analysts could spend more time on program evaluation. This redirection of effort should not adversely affect budget execution. For example, requests for appropriation transfers are time-consuming execution activities, but are very rarely denied, even after review by DPB budget analysts.

DPB Evaluation Section's Efforts Focus on Policy Analysis

The role of DPB's evaluation section, according to the section's manager, is to provide high quality analysis of State programs, services, or issues. The evaluations that are done use professional research methods and generally have a budgetary impact. As shown in Exhibit 6, however, few program evaluations have been performed during the

Figure 2

Percentage of Time DPB Analysts Spend on Job Activities



Note: Percentages do not add to 100 due to rounding.

Source: JLARC interviews with DPB budget analysts, July-August 1991 (N=10).

last five years. This is in contrast to the thousands of operating programs administered by State agencies. For example, one base budget program in the statewide program structure for the Department of Education, grant and loan administration, includes 100 distinct operating programs or activities. One reason for the lack of program evaluations has been that the evaluation section's efforts have been directed by the Governor's secretaries and legislative mandates toward policy analysis studies.

The need for additional program evaluation by DPB's evaluation section and budget staff is acknowledged by the current director. (In addition, according to the director of DPB, some program evaluations have been done that remain confidential working papers. For example, the evaluation section has taken the lead on a downsizing study across State government, which is not yet public.) As the director stated during interviews, "program evaluation needs to be beefed up and will be as resources become available. The budget process does not give enough attention to performance outcomes."

Exhibit 6

Examples of Studies Led by DPB Evaluation Section

Type of Evaluation	Subject/Title
Program	• *A Study of Secondary Vocational Education* (Phase II) (1989)
	• *A Review of the Commonwealth's Industrial Employee Training Program* (1987)
Policy and/or Staff Support	• *Governor's Commission on Educational Opportunity for All Virginians* (1990)
	• *Governor's Commission on Prison and Jail Overcrowding* (1990 and 1991)
	• *Implementation of Children's Residential Services Recommendations* (1991)
	• *A Study of Indigent Defense Systems in Virginia* (1989)
Organization and Management	• *Health and Human Resources Secretariat Consolidation* (1991)
	• *Staffing the Division of Child Support Enforcement* (1988)
	• *Staffing and Treatment in Adult Psychiatric and Geriatric Facilities of the Virginia Department of Mental Health and Mental Retardation* (1987)
	• *Staffing the Virginia State Library and Archives* (1989)

Source: Department of Planning and Budget listing, March 1991.

Program Evaluation by State Agencies is Varied

As part of this review, the 11 case study agencies were questioned about their internal evaluation activities. All 11 indicated that some type of evaluation was conducted on an on-going basis. The types of evaluation ranged from staff performance evaluations to the development of, and adherence to, a comprehensive plan. The following examples show the range of evaluation activity.

The Department of Personnel and Training indicated that it internally evaluates its own performance through staff evaluations. Individuals are evaluated on how their programs are functioning but the evaluations are not directly tied to the budget.

* * *

The Department of Fire Programs establishes performance standards and objectives for its programs. Strategies for meeting the standards and objectives are established by the Virginia Fire Services Board and the director every two years and coincide with the development of the agency's biennial budget. Programs are assessed against these standards and objectives.

Eight of the 11 agencies indicated that they had also been evaluated by an outside organization. However, at least half of these evaluations were of administrative activities such as staffing, procurement, or accounting. In addition, four of the eight agencies indicated that the evaluations were conducted by a legislative entity.

Nine of the 11 case study agencies stated that they do conduct program evaluations of their own activities. During this biennium, it appears that some State agencies conducted additional program evaluations in order to address the revenue shortfall and budget reductions. On the JLARC survey of State agencies, 41 percent of the agencies stating that the recent budget reductions had a positive impact on their agencies specifically cited the additional program evaluations as the positive aspect. However, these evaluations tended to be largely informal.

Performance Measures Are Not Routinely Used in the Budget Process

When adopting program budgeting in 1975, the General Assembly also required the development, reporting, and monitoring of performance measures as part of the budget process. Section 2.1-398 of the *Code of Virginia* requires the Governor to include performance measures to be used in monitoring and evaluating services. DPB is charged with monitoring State programs against these performance measures.

Performance measures can range from simple "clients served" and other output measures to more complex program effectiveness measures. While some case study agencies have an active performance measurement system in place, others do not.

The Virginia Department of Transportation (VDOT) has established performance measures for its programs. These measures are used when determining costs for the upcoming biennium and reflect the priorities of the six-year transportation plan. For example, for the secondary *maintenance program, performance measures in the department's 1990-92 proposal included the following:*

- *place 658,048 tons of patching material,*
- *clean 37,488 miles of ditches, and*
- *control vegetation of 90,571 lane miles of roadway.*

* * *

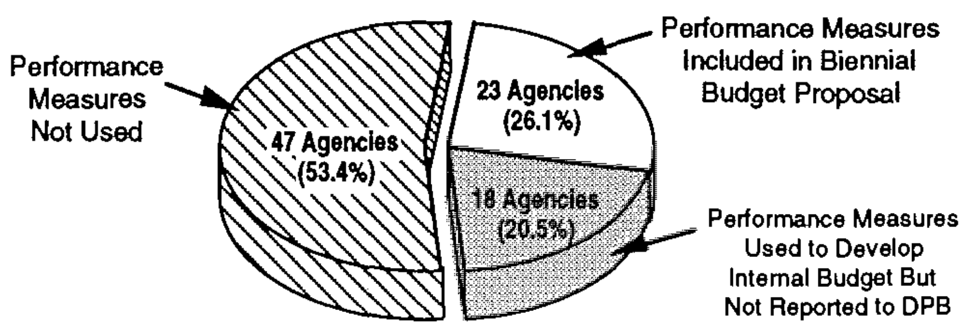
According to staff of the Department of Education, the agency did not have established performance measures for its programs through 1990-92 budget development. Therefore, performance measures have not been a part of their budget process to date. However, the department is currently developing such measures for future use.

As part of the JLARC survey of State agencies, 88 State agencies provided information about their use of performance measures. As shown in Figure 3, only 26 percent responded that performance measures were included in their 1990-92 budget proposal. However, an additional 21 percent of the State agencies surveyed indicated they use performance measures as part of their internal budget process but do not report them to DPB. The State agencies using performance measures indicated that they found them "somewhat useful" in developing their budget.

While DPB instructed agencies to provide "quantifiable strategy statements or verifiable program measures" in their 1990-92 budget proposals, DPB did not take any action if they were not included. Only three case study agencies routinely included

Figure 3

Use of Performance Measures by State Agencies



Source: JLARC survey of State agencies, summer 1991 (N=88).

measures in their proposals. Therefore, the majority of these DPB analysts could not have evaluated program performance using these measures. Further, eight of the 11 DPB budget analysts interviewed did not know whether their assigned case study agencies had established performance measures for their programs.

EXECUTIVE BRANCH EVALUATION SHOULD BE INCREASED

The identification of a lack of program evaluation in the executive branch is not new. Three previous studies concerning the budget process also identified the need to strengthen program evaluation.

DPB, consistent with its *Code of Virginia* responsibilities, should take the lead on strengthening the executive branch's program evaluation activities in two ways: (1) the DPB evaluation section should conduct more program evaluations of selected programs to determine their efficiency and effectiveness; and (2) DPB budget analysts should more routinely perform program review of agencies' base budgets. State agencies should provide DPB with support so that it can perform these evaluations. This support could range from providing information or resources to sharing internal program evaluations with DPB staff.

Further, DPB and State agencies should begin to develop performance measures for State programs and activities for use in budgeting. Because of concerns with their use, however, these measures should be developed on a pilot basis.

Previous Executive Branch Studies Have Recommended Strengthened Program Evaluation

Three previous reviews of the executive budget process have recommended more program evaluation by the executive branch or noted the lack of program evaluation as a serious weakness. The first study in 1978 found that budget reviews have "focused less on programmatic information than fiscal details and good program planning has been less encouraged and rewarded than it should have been."

The second study, conducted in 1981, concluded that the components of the program budgeting process that had not been fully implemented by the executive branch were planning, policy and issue analysis, and program evaluation. This report stated "careful consideration should be given to the tradeoffs between devotion of staff resources to detailed budget execution as compared to the evaluation function."

The third study was completed by the Department of Management Analysis and Systems Development (MASD) in 1982. This review found that DPB's *Code of Virginia* responsibilities concerning program analysis and review and evaluation were not being fulfilled. In addition, DPB displayed an "ambivalence" toward program evaluation according to the MASD report.

DPB Could Strengthen Its Program Evaluation Activities

Strengthening of DPB's program evaluation activities could be accomplished in two ways. First, the evaluation section could spend more time conducting program evaluations. DPB's evaluation section resources have often been dedicated to providing analytical staff support to gubernatorial or secretarial commissions. While the articulation of policy is important and has a budgetary impact, the evaluation of current programs and services is also necessary so that decisionmakers can be assured that legislative intent is being followed, that program goals are being met in an efficient manner, and that State programs are effective.

Second, DPB budget analysts could also increase the amount of time they spend on program evaluation when reviewing agencies' base budgets. This type of review would be focused on determining duplication of services, gathering reliable information that addresses the effectiveness of programs, determining if the most efficient processes are being used to deliver the programs, and determining whether the programs are still necessary. Details about this type of review are presented in Chapter II of this report.

Recommendation (13). **The Director of the Department of Planning and Budget should ensure that more of the evaluation section's effort is directed to program evaluations of existing State programs.**

Agencies Could Provide Resources for Program Evaluations

State agencies could work with DPB to conduct more program evaluations. Agencies could provide information and resources for this activity. This type of collaboration was recently undertaken by DPB and VDOT for an organizational study.

In addition, when agencies conduct internal evaluations of their own programs, these evaluations could be shared with DPB. During interviews with the case study agencies, agencies were asked if they report the information and findings they uncover during internal program evaluations. Only four of the 11 said they shared these with DPB routinely. However, two additional agencies not sharing the information with DPB currently said it would not influence the way their evaluations were conducted. For example, one agency deputy director stated:

> We should constantly 'tweak' organizations. If you do this, then you can fine tune them without a major upheaval. There's not a knee jerk reaction. And if the agency is the one evaluating and 'tweaking' they should be proud to share what they have learned about their programs.

Eight of the 11 case study agencies stated that two positive aspects of the recent budget reductions were that they forced them to evaluate their base budget programs and that DPB allowed agencies to determine where the budget reductions should be made. However, there is no formal mechanism in place in the executive branch that requires agencies to continue this level of program evaluation when revenues improve.

Three case study agencies are increasing the resources they dedicate to internal evaluations. These agencies are the Department of Education, the Department of Economic Development, and the Department of Rehabilitative Services. The analyses generated by these agencies, and similar ones in other agencies, should be used by DPB to augment its program evaluation activities.

Recommendation (14). **The Director of the Department of Planning and Budget should assess ways that agency program information and evaluation resources can be used by the department to increase its program evaluation activities. In addition, State agencies should share the information and findings they collect during their own internal program evaluations with the department.**

Performance Measures Should be Developed on a Pilot Basis

Performance measures, when used, can increase program accountability and help decisionmakers determine the efficiency and effectiveness of programs. Many national budget experts believe that performance measures will become a standard and routine part of all state budget processes. However, national organizations and other states have had problems in developing these measures.

The Secretary of Finance and the Director of DPB have been key proponents of efforts by national groups to develop performance measures for state governments. The Director of DPB is interested in working with Virginia's agencies to develop performance measures for evaluating their base budget programs. She envisions that this effort would be a pilot project in selected agencies over the next several years. While this pilot should be conducted by the executive branch, the legislature should have the opportunity to participate.

Performance Measures Have Advantages. Performance measures can increase accountability and can be used to determine the efficiency and effectiveness of State programs. Other advantages of performance measures include:

- enhancing decisionmaking about program and policy priorities;
- forcing logical thinking and careful examination of a program's functions;
- requiring effective, performance-oriented program management; and
- focusing agency management on providing substantive program performance.

While Many Budget Experts Cite Advantages, They Also Cite Problems. The National Association of State Budget Officers (NASBO), under the leadership of Virginia's Secretary of finance and budget director, recently coordinated an effort by some states to develop performance measures for tourism, child support enforcement, and mental retardation programs and budget agency operations. However, this effort met opposition when the developed measures were presented. The opposition was based on a lack of agreement on a definition of performance measures, on what type of performance measures should be used, and on the utility of comparing programs across states because of policy differences. As a result, NASBO is not planning on taking an official position in the next few years on the use of performance measures in the budget process but instead will be encouraging states to try them on a pilot basis.

The Governmental Accounting Standards Board (GASB), which is designated to establish standards of financial accounting and reporting for government organizations, has encouraged states to experiment with performance measures. GASB has also recently developed suggested measures for such areas as higher education, economic development, and mass transit. However, this effort has also met with opposition. Virginia's comptroller indicated during an interview that most state comptrollers' interest is directed at the development of performance measures for financial management, similar to those already used by Virginia for higher education institutions. Comptrollers are not supportive of evaluating and reporting program performance as part of their own yearly financial reporting requirements, he said.

DPB conducted a survey in 1990 of the 49 other states to determine what types of performance measures are being used and their usefulness. According to this survey, 33 states are currently using some type of performance measures. However, only 13 states used performance measures that would evaluate the performance of state programs. During this review, JLARC staff interviewed legislative budget directors in five of these 13 states. Two of the five indicated that performance measures were not useful in their budget process. The other three states described the measures as somewhat useful.

Additional Disadvantages of Using Performance Measures Have Been Cited. Professional literature, other states, and national studies cite additional disadvantages. One frequently cited disadvantage is that for some programs quantitative measures have not been effectively developed or used. Therefore, other types of evaluation tools would have to be used to conduct an accurate evaluation of the program. For example,

> *The Virginia Department of Transportation commissioner stated during an interview that "performance measures are a useful internal management tool." However, he is concerned with making them an external budget process tool because "they cannot replace program evaluation —going behind the measure to determine why the program has changed or is a problem."*

A 1990 national survey reported to GASB indicates that agency directors in other states have a similar concern. Only four of the 222 agency directors surveyed believed that performance measures should be included in an agency's published budget.

Other disadvantages of performance measures identified include:

- they do not guarantee greater control of agency spending;
- their costs in terms of time, money, and resources can be high;
- budget changes (such as reductions) can make comparisons of performance measures over time misleading; and
- they can be misused, becoming the focus of agency activities instead of a program's broader goals and objectives.

The Executive Branch Should Involve the Legislature in Its Attempt to Develop Performance Measures for Base Budget Programs. Experts in this area suggest that in order for performance measures to be used appropriately in the budget process, the legislature should be involved in their development. Reasons for legislative involvement include the following:

- ensures use of performance measures in budgetary decisionmaking;
- helps to focus the direction of programs and public policy; and
- ensures that program activities that are being conducted are fulfilling legislative intent.

Legislative involvement in other states has taken a variety of forms, as shown in the following examples.

In South Carolina, performance measures are not included in budget requests but are a mandated part of the annual reporting process to the legislature.

* * *

In Florida, the legislature prescribes the performance measures to be included in the gubernatorial and agency budget requests.

* * *

In Texas, the performance measures used by the executive branch must be approved by the legislature before they can be used. Also, any changes, deletions, or additions to the current performance measures must be legislatively approved.

Two concerns about legislative involvement in performance measures have been raised during this review. First, the development and monitoring of performance measures is typically a time-consuming and resource-intensive task, particularly difficult for citizen legislators. Second, agencies in other states have raised concerns that this involvement would invariably lead to reductions being made to agency budgets when measures were not achieved, even if there were legitimate reasons for not meeting the measures.

Recommendation (15). **The Director of the Department of Planning and Budget should proceed with her plans to develop performance measures for some base budget programs on a pilot basis. The opportunity to participate in the pilot exercise should be provided to legislative committees or their staffs.**

V. Information Provided to the General Assembly

The executive budget process should ensure that legislative decisionmakers have adequate time to examine the Governor's budget and adequate information on which to base decisions. Relative to other states, the General Assembly has substantially less time for consideration of the executive budget. Several options are proposed that would provide the General Assembly with more time to review the executive budget. Further, evidence suggests that accurate and timely information is being provided by the executive branch concerning agency budget proposals. However, some State agencies are being denied the opportunity to submit addenda that they deem necessary and appropriate.

TIME THE GENERAL ASSEMBLY HAS TO CONSIDER THE EXECUTIVE BUDGET IS LIMITED

In general, legislators in Virginia have approximately half the amount of time to examine the executive budget document as their counterparts in other states. This issue has prompted considerable legislative activity during 1990 and 1991.

Three options have been identified by JLARC staff that would provide legislators with more time to examine the executive budget. Each of these options has certain advantages and disadvantages. Based on its relative advantages, the General Assembly may wish to amend the *Code of Virginia* to require an earlier submission of the executive budget to the General Assembly.

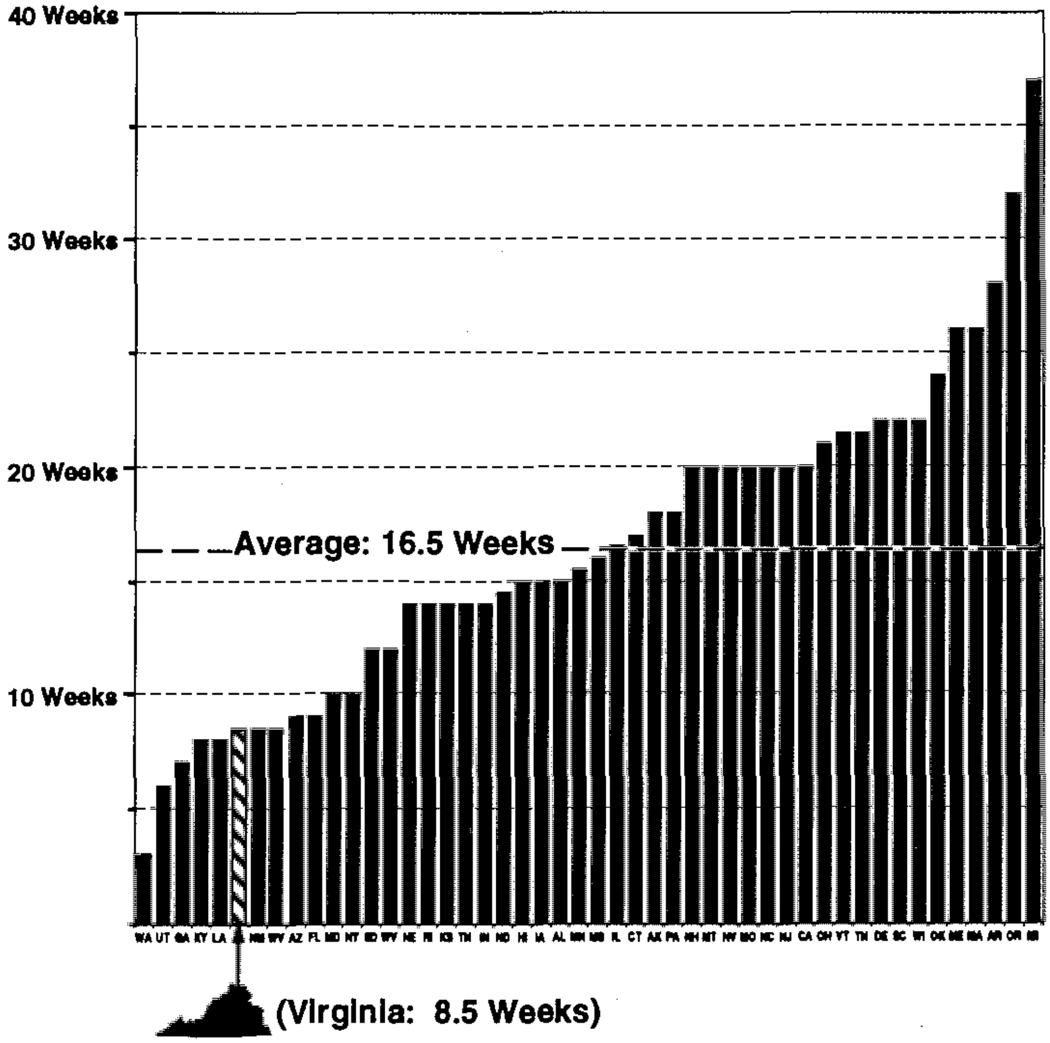
The General Assembly Has Limited Time to Consider the Governor's Budget

The General Assembly has only 8.5 weeks to consider the executive budget in an even year (60-day Session). This amount of time is approximately half the 16.5 week average for state legislatures (Figure 4). Only legislators in five states have less time to consider the executive budget.

Further, the General Assembly has approximately half the time to consider the executive budget as similar states — states with citizen legislatures and biennial budget processes (Figure 5). State legislatures using a biennial budget process (21 states) have an average of 17.4 weeks to consider the executive budget, compared to Virginia's 8.5 weeks. Citizen legislatures (39 states) have an average of 15.5 weeks to examine the executive budget, compared to Virginia's 8.5 weeks.

Figure 4

States Compared for Length of Time the Legislature Has to Consider the Budget Bill



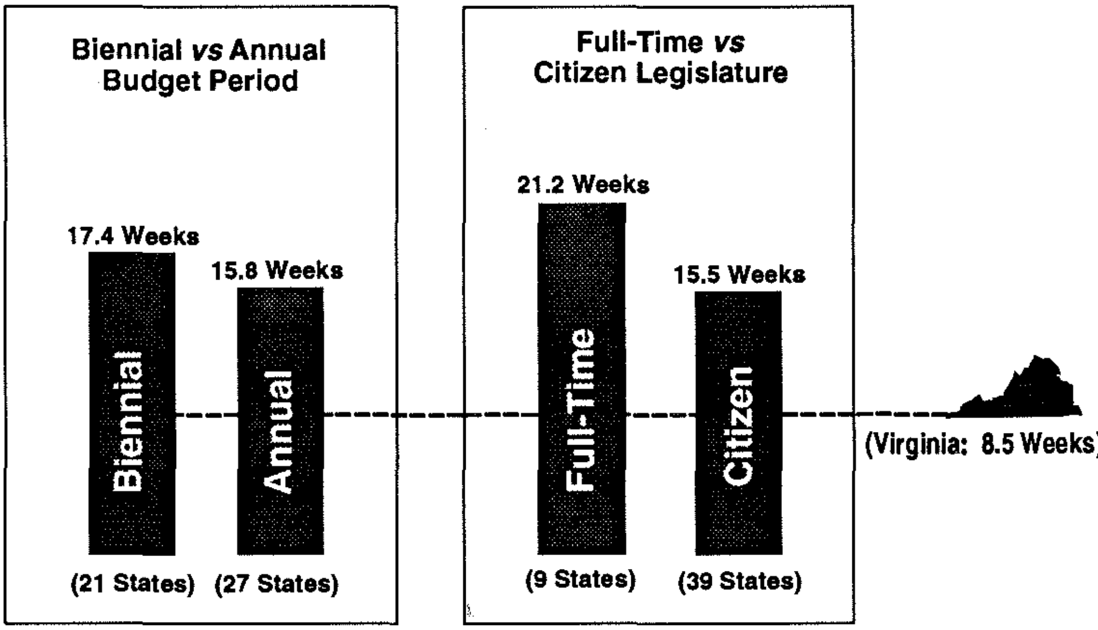
Source: JLARC analysis of *Legislative Budget Procedures in the 50 States: A Guide to Appropriations and Budget Processes*, National Conference of State Legislatures; and follow-up contacts with legislative staff in other states.

There Is Legislative Interest in Additional Time

There has been considerable legislative interest in the amount of time the General Assembly has to consider the executive budget. JLARC staff, in a presentation

Figure 5

Comparisons of State Averages for Budget Consideration Times
(by Type of Budget Period and by Type of Legislature)



Source: JLARC analysis of *Legislative Budget Procedures in the 50 States: A Guide to Appropriations and Budget Processes*, National Conference of State Legislatures; *State Legislatures*, National Conference of State Legislatures; and follow-up contacts with legislative staff in other states (two states did not provide information).

to the JLARC Subcommittee on the Executive Budget Process in October 1990, reported that earlier submission of the executive budget to the General Assembly would afford the legislature more time to consider the executive budget without requiring a constitutional change.

House Joint Resolution (HJR) 440, as agreed to by the House and Senate in the 1991 Session, proposes amending Section 6 of Article IV of the *Constitution of Virginia* to allow recess periods during the legislative Session not to exceed a total of 14 days with the approval of a majority of the members elected to each house. If this legislation is approved by the 1992 General Assembly, it will be submitted to the voters for ratification in November 1992.

It is also likely that the amount of time Virginia legislators have to examine the executive budget will be considered as part of Senate Joint Resolution 166, which requests the Joint Rules Committee of the House of Delegates and Senate to study certain aspects of the legislative process and reconvened Sessions. This resolution specifically requests that the study address the legislative calendar, including the desirability of providing for recess periods during the legislative Session.

Options for Increasing Time Have Relative Advantages and Disadvantages

There are three options for increasing the amount of time the General Assembly has to examine the executive budget. These options are not mutually exclusive. Depending upon how they are implemented, the additional time provided could benefit the House Appropriations and Senate Finance committees, the budget conferees, or the General Assembly as a whole. Each option has certain advantages.

The Options. The first option is requiring an earlier submission of the executive budget document and budget bill. The *Code of Virginia* would have to be amended to require an earlier submission. Section 2.1-398 of the *Code of Virginia* currently requires the Governor to submit the executive budget "within five days after the beginning of each regular session held in an even-numbered year of the General Assembly." Section 2.1-399 of the *Code of Virginia* requires that the Governor submit to the General Assembly "at the same time he submits his budget, copies of a tentative bill for all proposed appropriations of the budget . . . which shall be known as 'The Budget Bill'."

The second option would be to extend the length of the legislative Session. The *Constitution of Virginia* would have to be amended to allow for session extensions of longer than 30 days. Section 6 of Article IV of the *Constitution of Virginia* states:

> . . . no regular session of the General Assembly convened in an even-numbered year shall continue longer than sixty days; no regular session of the General Assembly convened in an odd-numbered year shall continue longer than thirty days; but with the concurrence of two-thirds of the members elected to each house, any regular session may be extended for a period not exceeding thirty days.

The third option is to have a recess during the legislative Session. An amendment to the *Constitution of Virginia* could be required because legislative Sessions are limited to 60 calendar days in even-numbered years and 30 calendar days in odd-numbered years. (Thirty-day extensions are available for each and theoretically could be used to extend the session for a budget-related recess.) There are two possible amendments which would allow a recess to occur. The first possible amendment would be to insert language that would exclude a recess from the 60- or 30-day Session limits, such as HJR 440 proposes. This type of amendment also was recommended by the Hopkins Commission in 1974. The second possible revision would be to change the calendar day restriction to a "legislative day" restriction, with legislative day being defined as any day the Senate or the House would be in Session. Either of these would allow a recess during the Session to occur.

Relative Advantages and Disadvantages of the Options. JLARC staff developed eight criteria to determine the advantages and disadvantages of the three identified options (Table 10). The criteria include:

- the provision of more time for budget examination;
- whether this time is dedicated to budget review;
- whether a constitutional change is required;
- impact on the concept of the citizen legislature;
- the relative cost;
- relative burden on State agencies;
- impact on the State's current budget development timeframe; and
- impact on the number of gubernatorial amendments.

Although each option has advantages and disadvantages, the option with the most advantages is an earlier submission of the executive budget. This option has five of the eight criteria as advantages. This option provides the General Assembly additional time that can be exclusively dedicated to review of the budget, does not require a constitutional amendment, and would provide additional time at a low relative cost without causing hardship to the legislature. Any mid-to-late December date chosen for the submission would have these advantages. The disadvantages of an earlier submission of the executive budget would be that it would require an alteration to the State's budget development timeline and may cause more gubernatorial budget amendments to be filed.

Both of the other options have several important disadvantages. While potentially providing extra time to the legislature for executive budget review, they do not ensure that the additional time would be spent on budget-related matters. In addition, one would clearly require an amendment to the *Constitution of Virginia* and the other may require such an amendment.

Requiring a December 20 submission of the executive budget document also would provide significantly more time for the General Assembly to consider the executive budget. A December 20 submission would afford the General Assembly between 18 and 31 additional days to examine the executive budget. These extra days would provide the General Assembly with a total of between 11 and 12 weeks to consider the budget.

Recommendation (16). **The General Assembly may wish to consider amending Section 2.1-399 of the *Code of Virginia* to require the submission of the Governor's budget on or before December 20. A similar change could be made to require the Governor's amendments to the biennial budget by this date in even-numbered years.**

Table 10

Advantages of Options to Increase the Time the General Assembly Has to Consider the Executive Budget

Advantage	*Option:* An Earlier Executive Budget Submission	Extension of the Legislative Session	Recess During Legislative Session
Additional Time for General Assembly Review of the Budget	✔	✔	✔
Additional Time Dedicated Exclusively to Budget Review	✔		
No Constitutional Change Required for Implementation	✔	?	?
Would Not Alter the Concept of Virginia's Citizen Legislature	✔		?
Relative Cost of Implementation Would Be Low	✔		✔
State Agencies Would Not Have Difficulty Meeting Deadline	?	✔	✔
No Alteration to Timeline for Budget Development		?	✔
Would Not Increase Gubernatorial Budget Amendments		✔	✔

Key:

✔ - Option provides advantage

? - Option may provide advantage depending on implementation

Source: JLARC analysis based on interviews with case study agencies, Department of Planning and Budget, and staff of the House Appropriations and Senate Finance committees.

ACCURATE AND TIMELY INFORMATION IS PROVIDED CONCERNING AGENCY BUDGET PROPOSALS

Despite concerns raised by agencies and legislative staff, it appears that the Department of Planning and Budget (DPB) does not alter agency budget proposals before providing them to the House Appropriations and Senate Finance committees. In addition, DPB has provided copies to these committees in a timely manner.

Currently, the Appropriation Act requires that agencies submit their budget requests or requests for amendments to the chairmen of the House Appropriations and Senate Finance committees upon request. Agencies do not directly submit their budget proposals to these committees. Instead, DPB has agencies submit extra copies to DPB, which it then forwards to the House Appropriations and Senate Finance committees without alteration. Since this practice is now customary and appears to address the needs of all parties involved, current practice should be formalized in the Appropriation Act.

The Appropriation Act, however, does not require that amendment proposals be forwarded to the legislature. Legislative staff indicated that while they received copies of the 1991 amendment briefs, they had to formally request some agency reduction plan amendments from DPB. The General Assembly amended the Appropriation Act (Section 4-1.04(a)) in the 1991 Session to specify that reduction plans be provided to the legislature by the Governor.

To ensure that agency amendment briefs are provided to the legislature, Part Four, Section 4-8.02(b) of the Appropriation Act could be amended to specifically include amendment briefs. In addition, the Director of DPB could be given direct responsibility for forwarding the documents to the House Appropriations and Senate Finance committees as they are received by DPB.

Recommendation (17). **The General Assembly may wish to consider amending Part Four, Section 4-8.02(b) of the Appropriation Act to include agency "amendment briefs" and omit the words "they shall also submit copies, if requested" and insert the words "the Director of the Department of Planning and Budget shall submit copies" to give the Director of DPB responsibility for forwarding these documents to the chairmen of the House Appropriations and Senate Finance committees as they are received by DPB.**

APPROPRIATENESS OF INFORMATION PROVIDED IN AGENCY BUDGET PROPOSALS VARIES

The *Code of Virginia* can be construed as requiring the Governor to have agencies follow a uniform budget format. However, a format has not been uniformly followed by all agencies. The *Code of Virginia* also requires that agencies be allowed to submit all addenda they deem necessary and appropriate in the odd-numbered years to fulfill the agency's program needs. In some cases, agencies have been denied this opportunity. (The *Code of Virginia* does not make the same requirement for budget amendments filed by agencies in even-numbered years, and agencies have been restricted in the types of amendments they may file. This is appropriate, however, since Virginia has a biennial budget process and changes in the second year should be as limited as possible.)

Differences in Higher Education Institutions' Budget Format

Old Dominion University fully complied with DPB's required budget format for higher education institutions, but the higher education format is different than the format for other agencies. DPB budget instructions make a distinction between higher education institutions and all other State agencies. The main difference in the required format is that higher education institutions are required to submit their budget proposals as an integrated package combining the base budget and initiative requests. All other agencies must submit separate base budget and addenda requests, with each addenda request being presented as a discrete decision package.

Those involved in the budget development process generally agree that the budget proposal format for higher education institutions is justified because of their unique reporting relationship to the State Council of Higher Education for Virginia. There is also general agreement that the format and information it provides is working to the satisfaction of all parties involved in budget development. Since all higher education institutions must follow the same budget proposal format, the submissions do not prejudice budgetary decisions against any one institution.

Differences in Other Case Study Agencies' Budget Proposals

Two other case study agencies' budget proposals for 1990-92 were different from DPB's uniform instructions. These agencies were the Department of Mental Health, Mental Retardation, and Substance Abuse Services (DMHMRSAS) and the Department of Rehabilitative Services (DRS). These proposals were different because the DPB budget analysts for the agencies created a unique package of supplemental budget instructions specifically for them.

The modification of the budget proposal instructions for these agencies could be construed as not being consistent with the intent of Section 2.1-394 of the *Code of Virginia* which requires that "the official estimate blanks which must be used in making these reports . . . shall be uniform." Agency budget proposals are used by many individuals in addition to DPB budget analysts. Legislators, legislative staff, and the public have access to, and routinely use, agency budget proposals for a variety of reasons including to make comparisons across agencies. While the modification of the budget instructions for this agency may suit the needs of DPB, it defeats one of the main purposes of requiring uniform submissions, which is to facilitate the use of the proposals by all interested parties.

Differences in DMHMRSAS's Budget Proposal. The differences were primarily that this agency, a system, filed its budget submission by facility, not by program. Each facility prepared its own base budget submission that was then compiled into the agency submission. Although each facility's submission varied somewhat in the information included, the facility proposals included some information at the program level. The program level information that was generally provided included an overview, a description of current service provision, and a 1990-92 service level description.

DMHMRSAS's DPB budget analyst said that the agency's budget instructions were redesigned to meet specific informational needs and to cut down on paperwork. The analyst indicated that if DPB uniform budget instructions required something from the agency that was not needed, the analyst no longer required the agency to file the information. The analyst indicated that they prefer to complete the analysis of the agency at the facility level, not on the program level, so the proposal instructions were modified to meet that need. The Director of DPB looks upon this modification of DPB's uniform budget proposal instructions favorably, stating that it is an example of the good relationship DPB analysts have with their agencies.

Differences in DRS's Budget Proposal. The Department of Rehabilitative Services' budget proposal included no subprogram narrative information, although it followed the required structure in all other ways. The only information provided at the subprogram level was a resource summary table for each subprogram. The sections that were omitted contained the most detailed information required concerning the agency's activities.

Recommendation (18). **The General Assembly may wish to consider amending Section 2.1-394 of the *Code of Virginia* to reflect current practice and allow for a budget proposal format to be submitted by all higher education institutions that is unique from the format required by all other agencies. In addition, the Director of the Department of Planning and Budget should ensure compliance with Section 2.1-394 of the *Code of Virginia* and require that all agency budget submissions be submitted in the uniform format prescribed by the Governor.**

Some Agencies Are Not Given the Opportunity to Submit All Addenda

Section 2.1-394 of the *Code of Virginia* states that "the Governor may prescribe targets which shall not be exceeded in the official estimate of each agency; however, an agency may submit to the Governor a request for an amount exceeding the target as an addendum to its official budget estimate." Therefore, the *Code of Virginia* allows State agencies to submit all addenda they deem necessary and appropriate as part of budget development.

Budget instructions DPB provided to State agencies to guide them in the budget development process were examined by JLARC staff. No language that could be construed as restricting agency addenda submissions was found in the budget development instructions for 1990-92 or 1992-94.

Also, four of the five DPB budget section managers indicated that no type of pre-screening of addenda takes place. The deputy director for budgeting at DPB has indicated that he is not aware of DPB ever preventing an agency from filing an addenda request in its budget proposal. However, one DPB budget section manager did indicate that preliminary addenda for the agencies assigned to his section are pre-screened by the Governor's secretary before they are officially submitted to DPB. Therefore, these agencies are unable to file all the addenda they determine as necessary and appropriate.

A former Governor's secretary confirmed that the pre-screening of addenda took place. According to the secretary, meetings were held with all the agencies in the secretariat to go over each agency's base budget and addenda proposals before they were officially filed with DPB, with the secretary determining which addenda could be filed by the agency.

The pre-screening of addenda requests may also be taking place as part of 1992-94 budget development. JLARC staff obtained a letter from a Governor's secretary written to a case study agency. The letter specifically dictates what addenda submissions the agency will be allowed to submit as formal addenda requests to DPB. The letter begins by stating, "I have reviewed your list of 1992-94 addenda. Attached are those addenda I am approving for submission." According to officials at the agency, they were required to submit a listing of all addenda the agency wanted to propose to the secretary. The agency was then prevented from submitting any addenda which were not included on the secretary's approval list even though these addenda were approved by the agency's board for submission and were part of the agency's six-year plan.

Not allowing agencies to formally submit addenda they deem as necessary and appropriate does not comply with Section 2.1-394 of the *Code of Virginia*. If agencies are prohibited from formally filing addenda, the General Assembly may never be aware that a need for additional funds was identified and requested by an agency.

Recommendation (19). **The Governor's secretaries and the Director of the Department of Planning and Budget should ensure compliance with Section 2.1-394 of the *Code of Virginia* by not restricting State agencies from filing addenda requests that they deem to be necessary and appropriate.**

EXECUTIVE BUDGET INFORMATION COULD BE IMPROVED

During JLARC's study of the executive budget process, some legislators have raised concerns about the budget information the executive branch provides to the General Assembly. These concerns have focused on the two budget documents the executive branch is required to provide to the legislature: the executive budget document and the budget bill. (While concerns were raised about the necessity for a separate budget tabloid in addition to the budget document, DPB has indicated the tabloid will not be produced during this administration. Therefore, this review will not address its usefulness.) Several improvements could be made to both the budget document and budget bill to facilitate their use by legislators, State agencies, and the public.

Improvements to the Executive Budget Document Were Cited

The *Code of Virginia* requires that the Governor submit the executive budget document to the General Assembly. Users of the document have suggested a number of ways to improve the document. Some legislators would like it to include information on funding to localities and to identify discretionary and nondiscretionary funding. Case study agencies would like it to include better information on State priorities and agencies and to highlight any significant changes to the agency's funding or programs since the previous budget document. DPB has recently taken several steps to assess and improve the usefulness of the document.

Legislators Would Like Additional Information on Aid to Localities. Some legislators have indicated that information on the amount of money in the State's budget for aid to localities would assist budget decisionmaking. Nine of the ten DPB budget analysts responding to this question indicated that there would be no problem providing aid to locality information. All eleven case study agencies indicated that they could easily provide information concerning the portion of their budgets that could be considered aid to localities. Several agencies indicated that they are already producing and using this information internally. DPB, by means of its 1992-94 budget instructions, is collecting this information from State agencies. According to the deputy director for budgeting, DPB will attempt to include this information in the 1992-94 executive budget document.

***Recommendation (20).* The General Assembly may wish to consider amending Section 2.1-398(4) of the *Code of Virginia* to require that the executive budget document include an identification of the portion of each State agency's budget that is direct aid to localities.**

Legislators Would Like Additional Information on Discretionary and Nondiscretionary Spending. Some legislators have indicated that the identification of discretionary and nondiscretionary spending by agencies would assist them in the appropriation process. They note that discretionary funds are the only portion of the budget that policymakers can impact and clear identification of these funds would facilitate budgetary decisionmaking.

There is no consensus in budgeting literature or among the officials in Virginia's budget process concerning an appropriate definition of discretionary and nondiscretionary spending. Legislative staff defined nondiscretionary spending as consisting of two elements, debt service and federal mandates. The Director of DPB has stated that DPB, during budget reduction exercises in 1990, defined nondiscretionary items as being entitlements, direct public safety, direct health care, accreditation standards, and health and safety functions. DPB's deputy director for budgeting has defined nondiscretionary funds as standards of quality for primary and secondary education, mental health, corrections, and higher education. The deputy director indicated that higher education would be discretionary if "massive" changes to policy were made, but barring these it is nondiscretionary.

Six of the eight DPB budget analysts asked stated that they thought nondiscretionary funding information could be provided. The majority of the analysts indicated, however, that the terms would be very difficult to define and the process would be difficult to implement. Five analysts also were concerned that the term discretionary would be misinterpreted and misunderstood. They indicated that the public might interpret discretionary spending as something negative — as unnecessary spending.

Nine of the eleven case study State agencies stated that they could provide the information if they were provided with a clear definition of the terms. Two agencies indicated that they are currently producing this type of information for their internal use. One case study agency indicated that the entire agency's efforts could be considered discretionary, while another case study agency indicated that all of its efforts were nondiscretionary.

Further decisions must be made even after a definition of nondiscretionary spending is agreed upon. Decisions must be made concerning what level of program or service effort is considered required and thus nondiscretionary for a mandated program or service.

The degree of difficulty for an agency providing information on discretionary and nondiscretionary spending appears to be directly related to the size and programmatic complexity of the agency involved. For a small agency with a simple program structure, it would be easy to report this type of information. For a large and programmatically complex agency, this task would be difficult and time consuming.

> *The Department of Fire Programs is a small agency (in terms of total funding) and receives appropriations for two programs. According to the support services manager, the agency has no debt service and does not operate under any federal mandate. All agency operations are mandated by the* Code of Virginia. *Therefore, if nondiscretionary spending is defined as including State mandates, the agency's operations are nondiscretionary.*

* * *

> *The Department of Mental Health, Mental Retardation, and Substance Abuse Services is a large agency (in terms of total funding) and receives appropriations for eight programs. For spending identification purposes, the department separates its activities into two areas — the operation of facilities and grants to localities. Policy decisions would*

be required in both areas detailing what should be considered as nondiscretionary.

For facilities, Code of Virginia *mandates are limited leaving much concerning nondiscretionary spending open for debate. The majority of the department's clients are committed by court order — a clear mandate. However, a small percentage of clients are seeking voluntary court commitment or could do so. A decision would be required concerning whether the department is mandated to serve these voluntary clients. In addition, if the State elects to participate in the Medicaid and Medicare programs, numerous federal mandates must be met. Finally, if the State elects to meet national accreditation standards, numerous accreditation mandates must be satisfied.*

For grants to localities, the department provides funding to Community Service Boards instead of direct services to clients. The boards have several tasks mandated by the Code of Virginia. *In addition, if the State elects to participate in the Federal Block Grant program, numerous federal mandates must also be satisfied. The remainder of the grants to localities are spent in an attempt to prevent potential clients from requiring placement in the department's facilities, thus requiring the expenditure of an even greater amount of nondiscretionary funds. A policy decision would be required as to whether this "preventive funding" is nondiscretionary since it directly impacts the level of nondiscretionary funds expended by the facilities.*

DPB is planning to include information on discretionary and nondiscretionary spending in the 1992-94 budget document. As part of budget development, agencies were required to submit separate addenda submissions for aid to localities and for State and federal mandates. However, the aid to localities submission did not distinguish between mandated and discretionary aid. In addition, the State and federal mandate submission excluded mandated aid to localities. Therefore, the information collected by DPB may not clearly distinguish discretionary and nondiscretionary spending.

Recommendation (21). **If the General Assembly determines that the executive branch should provide information concerning discretionary and nondiscretionary spending, staff of the House Appropriations and Senate Finance committees should work with the Director of DPB to produce an agreed-upon definition of discretionary and nondiscretionary spending. If a definition can be agreed upon, the information could then be required by amending Section 2.1-398(4) of the *Code of Virginia* to add discretionary and nondiscretionary information in the executive budget document.**

Agencies Have Suggested Improvements to the Executive Budget Document. One-half of the case study agencies found the executive budget document useful in its current form, while half rarely used it. Case study agencies who found it useful cite the following reasons: it provides agencies with their first opportunity to see the Governor's recommendations concerning their agency budget proposal submissions; it gives them agency-specific policy guidance; and it provides an indication of the overall policy priorities of the Governor. Of the agencies which did not find the document useful, the main reason was that these agencies already were aware of what the document contained so that it provided no new information.

The case study agencies suggested three modifications to the budget document to improve it. Agencies suggested that the budget document include information on the "big picture" similar to what was provided by Governor Baliles' administration in the budget tabloid. Some agencies stated that this element was missing in recent budget documents. Another suggested change was to provide a meaningful overview of each agency in the document. As one case study agency stated, "the budget document provides little more information about an agency than what is included in the budget bill — if you do not understand the budget bill, you will not understand the budget document." Another agency stated that the information supplied about agencies in the budget document is "sparse and incorrect." The final case study agency suggestion was to fully explain any significant changes made to an agency's budget in the budget document.

DPB has recently taken several steps to assess and improve the usefulness of the executive budget document which should address agency concerns. DPB conducted a survey of agencies, legislators, and the press to gather information about the usefulness of the document. According to DPB's deputy director for budgeting, the budget document has typically made it difficult for legislators to understand the evolution of an agency's funding level — "of how an agency's funding got from point A to point B."

Therefore, DPB plans to have the 1992-94 executive budget document show each agency's budget balanced to the 1991 Appropriation Act with all changes to an agency's budget being noted from this point. DPB also plans to include a policy perspective throughout the document. An attempt will be made by DPB to capture the "big picture." For example, one DPB official said disparity will be examined, not just for education, but in all areas where localities receive funding.

Improvements to the Budget Bill Were Suggested

The *Code of Virginia* requires the Governor to submit the budget bill to the General Assembly. The format and content of the budget bill are important because they are directly related to the form and content of the Appropriation Act. The reason for this is that once the budget bill is passed by the General Assembly and signed by the Governor, it becomes the Appropriation Act.

JLARC staff compared the 1988 Appropriation Act (Chapter 800) to the budget bills of 37 other states. This comparison shows that there is a considerable amount of variation in the format and content of states' budget bills, with none appearing to have a "model" bill. Virginia includes two of the most used characteristics of budget bills, but does not include the next seven most used characteristics (Table 11). Several changes to the budget bill have been suggested by legislators and legislative staff.

Table 11

Characteristics of Other States' Budget Bills Compared to Virginia's

Budget Bill Characteristics	Number of States	Percent*
Similar to Virginia		
Maximum employment level for each agency	25	68%
Text description of how funds are to be spent	23	62
Detailed listing of all nongeneral funds	9	24
Text requiring studies	8	22
Language limiting governor's authority during a deficit	6	16
Funds appropriated to nonstate agencies	5	14
Dissimilar to Virginia		
Data on agency appropriations and expenditures for at least one previous fiscal year	23	62
Descriptions of agencies and programs	18	49
Expenditure data at the element level (provides a description of activities e.g. postage)	17	46
Revenue projections for fund sources**	14	38
Proportion of general fund expenditures by secretariat*	12	32
Components of general fund revenue**	12	32
Performance evaluation measures for agencies	11	30
Section detailing grants to localities	1	3
Identification of discretionary spending	0	0

*Based on 37 states examined.

**Included in Virginia's budget document, but not in budget bill.

Source: JLARC analysis of information provided in 37 other state budget bills to Chapter 800, the 1988 Appropriation Act.

Legislators and Legislative Staff Would Like Additional Information on Actual Appropriation Levels. Information concerning total agency appropriations is not readily available to legislators, legislative staff, and the public. This information is not provided because the budget bill and Appropriation Act Part One line items do not include regrades and other central appropriations. Given the length of the Session, inclusion of the regrades and central appropriations in agency appropriations is not currently feasible. These central accounts are disbursed to the agencies after the Appropriation Act is printed. For example, the 1989 Appropriation Act lists the Department of the Treasury as having a FY 1990 appropriation of $7,132,054. However, after regrades and central accounts had been included, the total agency appropriation increased 2.2 percent to $7,289,380.

Legislators and legislative staff have said this type of information in a centralized report would be beneficial. This information could be provided in the *Monthly Report to the Governor* produced by the Department of Accounts. This report currently provides agency-specific information on agency allotments, expenditures, and employment levels. Providing initial total appropriations for each agency for the current fiscal year would be a matter of including one column of additional information to which the comptroller already has access.

Recommendation (22). **The Comptroller should provide information concerning each agency's initial total appropriation (Appropriation Act appropriation in Part One plus all central account and Part Three transfers and modifications) for the current fiscal year in the *Monthly Report to the Governor.***

Each System of Agencies Should Be Given A Single Agency Code. The budget bill and the Appropriation Act report each agency within a system as separate entities. Even though some legislators like to see the appropriations to these agencies listed individually, the information provided is not accurate. The information can be misleading since a system transfers funding and positions among agencies within the system.

As found in the 1990 JLARC study of the Virginia Community College System (VCCS), the practice of listing system appropriations by agency can provide a distorted view of actual funding. Since the VCCS can transfer funds between programs and colleges (with DPB approval), Appropriation Act amounts can bear little relation to an individual college's funding.

> *The 1989 Appropriation Act indicated that Tidewater Community College was appropriated $27.5 million dollars and had a maximum employment level (MEL) of 719. Internal allocations by the VCCS central office provided the college with $30.1 million and a MEL of 764, an increase of 9.4 percent in funding and 6.3 percent in positions.*

* * *

> *The 1989 Appropriation Act indicated that Eastern Shore Community College was appropriated $2.5 million and had a MEL of 56. Internal allocations by the VCCS provided the college with $1.9 million and a MEL of 46, a reduction of 20.8 percent in funding and 17.9 percent in positions.*

In FY 1990, every community college received an initial allocation that was different from the 1989 Appropriation Act. DPB's deputy director for budgeting has stated that while the agencies under the Department of Corrections receive the approximate amount that is listed in the Act, the amount individual agencies under the VCCS and the DMHMRSAS receive can vary "tremendously" from what is stated in the Act.

The reporting of systems of agencies as separate entities also causes administrative burdens when resources are shifted. Using VCCS as an example, each college appropriation may be altered numerous times during the fiscal year, beginning when the VCCS initially reallocates the funds and later due to VCCS actions or DPB changes. Each of these adjustments may require a separate action for each college and the central office. The VCCS must request authorization from DPB to transfer the funds. Requests for 364 separate transfers were required in FY 1989.

The Department of Corrections formally requested on August 21, 1991 that DPB consolidate all the agency codes in the corrections system in the budget bill and combine them into one agency code. DPB's response to this request was that "such streamlining may be beneficial" but that further discussions would be needed to resolve some questions. The letter indicated that these questions would not be resolved in time to make all necessary changes for 1992-94 budget development, but could be considered for the future. The VCCS has also indicated that they would be interested in having one agency code in the Act. The Director of DPB has stated that she would like to see systems of agencies reported as one agency in the budget bill and the Appropriation Act. According to the director, managers of systems should have the flexibility to manage them. In addition, the comptroller has also lent his support to the idea.

One agency code in the Appropriation Act for systems of agencies should not impact the systems' or the Department of Accounts' ability to provide spending information at the individual agency level. The individual agency codes could be maintained on the Commonwealth's Accounting and Reporting System or project codes could be used for accounting and expenditure information purposes.

Recommendation (23). **The Governor and General Assembly may wish to consider modifying the way systems of agencies are currently structured and reported in the budget bill and Appropriation Act by combining all agencies within a system into one three-digit agency code.**

VI. Managing the Budget Process

This JLARC review did not focus on the organization and management of the central agencies involved in the executive budget process. During the course of this review, State agency personnel, legislative staff, and other participants in the process commented on the increasing professionalism of the Department of Planning and Budget (DPB) during the past decade. Agencies also suggested areas where refinements to DPB's operations and computer resources could enhance the budget process.

REFINEMENTS TO DPB'S OPERATIONS COULD ENHANCE THE BUDGET PROCESS

State agencies in many ways are dependent on DPB staff to articulate their budgetary needs to the Governor, secretaries, and to the General Assembly. During the course of this review, many State agencies commented on the professional quality of DPB's management leadership and staff. Over the last 10 years, the department has made significant strides in strengthening its staff capabilities.

However, agencies did identify several aspects of the budget process that require DPB's attention. The role of DPB staff is unclear and has not been formally communicated to agencies. This problem is compounded by a lack of continuity in budget analysts and limited visits by DPB budget analysts to agencies. Consequently, some agencies lack confidence that DPB budget analysts know their programs well enough to describe and defend their needs. Attention to these concerns would give agencies more confidence that DPB analysts fully understand their programs.

Further, agencies cite a lack of guidance, training, and opportunity for input from DPB. Agencies were especially critical of budget instructions, finding them difficult to understand and open to interpretation. Agencies were also concerned with DPB's lack of regard for the impact that short deadlines and changing budget calendars have on them.

The Role of DPB Budget Analysts Could Be Clarified

DPB's role in the budget process appears to be two-fold. It is partly to develop the Governor's budget and partly to support the agencies in articulating their budgetary needs. This dual role appears appropriate when balanced between the two. However, the role varies within DPB and between budget analysts. The role appears to be open to interpretation by each DPB budget analyst or section manager.

Seven of the 11 case study agencies stated that DPB sees its role as "control" or even "all powerful" during budget development and execution. One agency indicated that the DPB budget analyst assigned to them tries to be too involved in operational decisions and has to be reminded that he is not the agency director:

> The DPB budget analyst assigned to our agency has as his first loyalty the budget philosophy of control and restricting allocations. He wants to make policy and operational decisions such as how many support personnel are necessary at a particular agency office. The problem is that the decisions made are opinionated judgments or decisions and because DPB has the right ear [of the secretary or Governor] the decisions can be made without due process.

Another agency described the role of the DPB analyst as:

> . . . establishing statewide fiscal policy and implementation. The role of the DPB budget analyst should be to help the agency understand how they fit into this. However, they shouldn't substitute their knowledge or judgment for that of the agencies.

Two of the 11 agencies stated that DPB sees it role as supporting the agencies. Finally, two case study agencies stated that their current analyst's role has been as a technician. One agency official noted:

> The DPB budget analyst currently assigned to our agency is a financial/technical evaluator. He is a number cruncher. Not all of our analysts have been that way — the DPB budget analyst should be an advocate and an agency program specialist.

Five of the 11 DPB budget analysts defined their role in the process as agency advocate and liaison. However, analysts did not agree on what DPB's management considered to be the most important aspect of their job. The five DPB budget section managers also did not agree on their section's role in the budget process. For example, one section manager described the role of his section as implementing the Governor's policy objectives through allocating resources to the programs and agencies assigned to his section. Another manager, however, described his section's role as providing analysis and recommendations to the Governor and surfacing issues that need attention to help define policy.

Continuity in DPB Analysts Assigned to Agencies is Limited

During this review, it became apparent that the majority of State agencies do not have the same analyst assigned to them for longer than one budget cycle. Of the 11 case study agencies, only three had the same analyst assigned to them during 1991 as they did when they developed their 1990-92 budget in late 1989. According to the JLARC survey of State agencies, the average time the current DPB analyst had been assigned to a State agency was 16 months.

Agencies were asked on the JLARC survey of State agencies how many DPB budget analysts had been assigned to them during the last five fiscal years. The average was three analysts. The majority of agencies had had at least three analysts, and some had had as many as six.

Agencies with more than $110 million in total funding had the most continuity of analysts (Table 12). Small to medium-sized agencies (in terms of total funding) had the highest number of analysts in the five-year period. These agencies also had their current analyst assigned for the least amount of time. Problems created by this lack of continuity were identified by the case study agencies as the following example illustrates.

> *An agency director noted that "clearly turnover is damaging to the process and the agency . . . . it is very difficult for budget analysts to understand what we do." The agency director said that "changing DPB analysts in the middle of a legislative session was especially difficult when decisions were revisited because the new analyst did not understand them enough to defend them."*

Some changes in assignments are to be expected as a result of normal agency turnover (defined as personnel leaving an agency). However, turnover at DPB has been less than 15 percent among budget analysts for each of the last three fiscal years. And, as the DPB director notes, rotation of agency analysts may be necessary when analysts become "too much of an advocate" for their assigned agencies. Analysts have also received internal transfers or promotions which caused shifts in agency assignments.

Table 12

Average Continuity of DPB Analysts by Size of Agency (Total Funding)

Size of Agency	Time Current Analyst Assigned to Agency	Number of Analysts in Last Five Years
Small — less than $12 million (37 agencies)	1.2 years	3.1
Medium — between $12 and $110 million (35 agencies)	1.2 years	3.5
Large — more than $110 million (16 agencies)	2.1 years	2.9

Source: JLARC survey of State agencies, summer 1991.

However, the director also noted that she would prefer analysts to stay with an agency through at least one full budget cycle. Only 25 percent of the State agencies experienced that desired level of continuity.

Some continuity can be maintained even when an analyst leaves DPB, or is reassigned. For instance, files from the previous analyst can be transferred to the new analyst. However, when the eight analysts not assigned to their case study agencies for 1990-92 budget development were asked what information had been left for them by the previous analysts, only two of the eight indicated that a complete set of files was left. Two analysts indicated that while some materials were left, they did not know the source and would not use them. Finally, four other analysts indicated that some working papers were left and two of these analysts had access to the agency's previous budget analyst.

DPB's budget section managers noted that they can also provide some continuity. However, the average amount of time the section managers had been in their positions was 3.15 years, with three of the five having been in the position less than two years. The current director has begun a new effort to improve continuity by having all budget sections write agency summaries so that general information about each agency can be passed on to a new analyst.

DPB Analyst Visits to Assigned Agencies Are Limited

According to the five DPB budget section managers, one of the ways DPB budget analysts learn about agency programs is by visiting them. They described these visits as "very important." However the number of visits made by DPB analysts appear minimal. In addition, no mention of agency visits appear in model expectations or in position descriptions for DPB analysts. The minimal number of visits, coupled with the short agency assignments noted earlier, raises questions about DPB analysts' ability to understand the programs offered by the agencies assigned to them. In fact, five of the 11 DPB analysts interviewed did not know how the case study agency assigned to them internally developed its budget.

Agencies were asked on the JLARC survey of State agencies how often during the last fiscal year (July 1, 1990 to June 30, 1991) their DPB analysts had visited their agency to learn more about agency programs and services. The average was six visits, with the median being only three visits. Five of the 88 agencies surveyed had not been visited at all, and 20 agencies had only been visited once.

The concern about the lack of field visits by DPB analysts is not new. The 1982 organization and management review of DPB completed by the Department of Management Analysis and Systems Development (MASD) emphasized that the lack of field visits was a concern. The MASD review recommended that DPB increase the number of field visits.

According to one section manager, the director and deputy director for budgeting at DPB have encouraged agency visits. The director has also completed agency visits.

For the most part, however, agency visits are left up to the individual budget sections. For the health and human resources section, the manager indicated that a requirement for visits is written into performance standards for new analysts assigned to that section. Analysts in this same section are also required to document their visits to the agencies. In the other sections, analysts stated that the documentation was informal and generally not required.

More DPB Guidance, Training, and Opportunity for Input is Needed

During this review, case study agencies commended DPB analysts for their responsiveness to agency telephone inquiries during budget development. However, agencies did express frustration concerning the budget development instructions provided to them by DPB. They also voiced concerns about changes to the budget development calendar and the lack of opportunity they have for input in setting it. The following are examples from the State agency survey.

> The DPB budget instructions for biennial budget submissions have varied considerably during the last five fiscal years. A problem that often presents itself in working with DPB is that instructions and assignments prepared by the Budget Operations Section (BOS) are not adequately shared and coordinated with DPB's budget sections prior to their distribution to State agencies. Therefore, DPB budget analysts assigned to working with State agencies are many times in the dark about how a process should be accomplished or what the intent of the exercise is, even though the BOS-penned instructions always say something like 'call your assigned DPB analyst for help in completing this assignment.'
>
> Later in the process when BOS provides the DPB budget analysts with instructions to review and analyze agency budget submissions, these instructions more often than not contradict the directions for the same exercise originally sent to the agencies. This has caused the agency to be asked by its DPB analyst why certain information, for instance, was not provided in a submission. This agency has responded by pointing out that the instructions the <u>agency</u> received did not solicit that data or method of submission.
>
> * * *
>
> An additional problem for the development of the 1992-94 budget request is that DPB has not provided an overall calendar of submission requirements and deadlines.... This makes it difficult for institutions to adequately plan, organize, and schedule their own internal procedures for development of the budget request.

Results of these problems include that agencies do not feel that they are given adequate time to properly prepare their budgets. Further, they believe that DPB makes changes to the process to make DPB's job easier with little consideration of the impact on agencies. Forty-one percent of surveyed agencies said DPB's deadline changes in budget development had posed significant problems for their agency during the last five fiscal years. One State agency wrote:

> The time periods allowed for development of the capital outlay and operating budgets have become more compressed every two years. This would not be a problem if the general format were similar. However, major changes in format and form does not allow adequate time to evaluate the substance presented. This is particularly true in the 1992-94 biennium process.

Another agency wrote:

> The 1990-92 biennium budget deadline for submission to DPB was moved from September 1 to August 1. This had a drastic impact on the agency's financial personnel who are responsible for year-end closing and budget preparation. This also created significant problems for the development, review, and approval of policy addenda by top management.

In addition, DPB generally does not provide formal training to State agencies on the budget process. The only training that has been provided to agencies on a statewide basis during the last several years was that on the new Form 27/27A Automated Transaction System.

Only DPB's health and human resources section provides any formal training — a half-day session at the beginning of biennial budget development. This training, however, was described by agencies as "telling not teaching." Seven of the 11 case study agencies stated that DPB needs to provide training for agencies. For example, one agency finance director stated:

> DPB doesn't have a vehicle for good agency input. They don't meet with budget directors together. Other central agencies try to bring agencies together.

An agency wrote as part of its response to the State agency survey:

> One of the biggest weaknesses in the budgeting system is the lack of facilitated networking and training. The role of "budget officer" and "fiscal officer" is extremely varied throughout the State. DPB should make a concerted effort to bring the various line agency budget people together on a regular basis in facilitated work groups to discuss needs, problems, and ideas of common interest.

Reasons why DPB should provide training, according to State agencies, included the following:

- to provide an opportunity to discuss and meet with budget staff from other agencies;
- to provide an opportunity to meet with DPB staff and provide input into the budget process in an informal setting;
- to provide new agency budget staff with a "big picture" understanding of the process; and
- to explain changes to the process whether they be in development, execution, or evaluation.

The case study agencies appreciated the opportunities for input and training they are provided by the Department of Accounts (DOA). This is assured through the monthly Commonwealth's Accounting and Reporting System (CARS) user group meeting and the annual DOA conference. In addition to learning new information, this training was viewed as a forum for input and an opportunity to share information between agencies. The majority of case study agencies expressed a desire for a similar opportunity with DPB, although the case study agencies thought monthly meetings would be excessive.

Another way agencies could receive guidance on the budget process is by following the *Commonwealth Planning and Budgeting System Manual.* However, there appears to be confusion regarding whether this manual, which provides the history and guidelines for the State's budget process, is still in effect. For example, some DPB analysts and section managers thought the manual was in effect, while other managers and analysts thought it was not.

Case study agencies, however, thought that the manual was still in effect and many have been using it as general guidance regarding the budget process and as an orientation for new budget staff. If the *Commonwealth Planning and Budgeting System Manual* is no longer in effect, there is no written guidance except the *Code of Virginia* to explain the budget process to agency directors and fiscal staff.

Recommendation (24). **The Director of the Department of Planning and Budget should do the following:**

- **Formally articulate the role DPB budget analysts should have in the budget process with particular attention to the role of DPB and DPB budget analysts *vis a vis* State agencies. Further, appropriate training programs should be developed for section managers and budget analysts when this role is agreed upon.**

- **Promote continuity in analysts' assignments during a biennial budget cycle.**

- **Encourage analysts to visit their assigned agencies by adopting an agency-wide policy that fosters these visits. In addition, the Director of DPB should add agency visits to the model performance expectations and position descriptions for analysts at all levels.**

- **Ensure that semi-annual training on the budget process is made available to agency directors and agency fiscal staff. The training sessions should be structured so as to allow agencies an opportunity for providing input into DPB budget instructions and the budget development calendar, as well as an opportunity for providing DPB with feedback regarding the budget process.**

- **Provide guidance to DPB staff and to all State agencies concerning what sections of the *Commonwealth Planning and Budgeting System Manual* are still in effect. In addition, DPB should provide agencies with general guidance on the budget process and its intent if the guidance included in the manual is no longer current or in effect.**

DPB'S COMPUTER RESOURCES COULD BE ENHANCED

The Program Budgeting System (PROBUD) was designed in the late 1970s as a central resource allocation model for the State's budget. According to the DPB deputy director for management and evaluation, it was not designed for use by line agencies to develop their budgets. Some agencies have developed computerized budgeting capabilities that are more advanced than those found in DPB.

Also, according to the JLARC survey of State agencies, 87 percent of executive branch agencies have their own automated budgeting capability. These systems ranged from simple spreadsheets to large mainframe systems (Figure 6).

Agencies also provided information as to why they have developed their own automated budgeting systems instead of using PROBUD. One agency wrote:

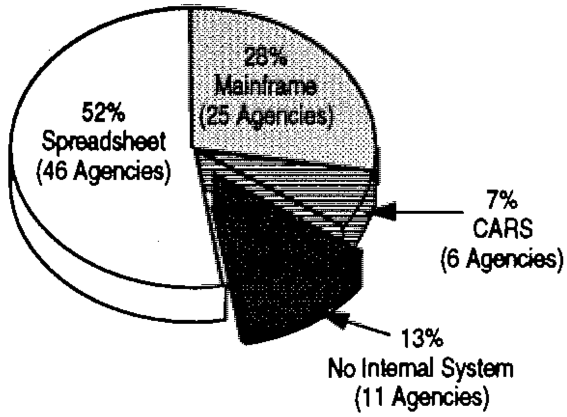
> Systems separate from PROBUD are necessary because PROBUD is not flexible enough for continually changing agency needs . . . . a considerably lower level of detail than PROBUD [is needed].

Another agency stated:

> PROBUD is designed to collect and report large volumes of similar data. Its data manipulation capabilities, at least from the individual line agency's perspective, are extremely simplistic and cumbersome.

Figure 6

Automated Budgeting Systems in State Agencies



Source: JLARC survey of State agencies, summer 1991 (N=88).

DPB is aware of the limitations of PROBUD and its in-house personal computer analytical capabilities. During this review, DPB indicated that it plans to comprehensively analyze and improve PROBUD. Nine of the 11 DPB budget analysts interviewed by JLARC staff stated that PROBUD has limitations that hinder their ability to do their job. These limitations, as cited by the analysts, included a lack of revenue information, no spreadsheet ability, timeliness, and inability to perform mathematical functions. Analysts also complained that PROBUD and the Commonwealth's Accounting and Reporting System "don't talk to each other," and "PROBUD is always a month behind because CARS doesn't feed directly into PROBUD."

Further, many DPB budget and evaluation analysts and managers do not have personal computer analytical resources readily available to them. The lack of these resources seriously limits the amount and type of evaluation and monitoring that DPB analysts can routinely perform concerning agency budget proposals and expenditures. The director has been working to acquire additional computer and software resources and has indicated she will continue to do so as resources become available.

Recommendation (25). **The Director of the Department of Planning and Budget should continue to pursue the acquisition of personal computer analytical resources for all DPB budget and evaluation analysts. The Director should also ensure that problems with PROBUD identified by DPB budget analysts during this review are addressed in the agency's information technology plan or as part of the agency's current effort to improve PROBUD.**

Appendixes

Appendix A

Study Mandate

In Item 13 of the 1990 Appropriation Act (amended in the 1991 Session), the General Assembly directed the Joint Legislative Audit and Review Commission (JLARC) to study the executive budget process. Item 13 specifically provides:

> The Joint Legislative Audit and Review Commission shall review the Commonwealth's executive system of financial planning, execution and evaluation including an evaluation of the organization, management, and operations of the Virginia Department of Taxation. The scope and duration of the review shall be determined by the Commission. The Commission shall report on its progress to the 1991 General Assembly Session and to each succeeding session until its work is completed. In carrying out this review, all agencies shall cooperate as requested and make available all records, information and resources necessary for the completion of the work of the Commission and its staff.

Appendix B

Legislation Establishing Program Budgeting

CHAPTER 325

An Act to amend and reenact §§ 2.1-54, 2.1-60 and 2.1-61, as severally amended, of the Code of Virginia, relating to the State budget.

[H 1778]

Approved March 18, 1975

Be it enacted by the General Assembly of Virginia:

1. That §§ 2.1-54, 2.1-60 and 2.1-61, as severally amended, of the Code of Virginia are amended and reenacted as follows:

§ 2.1-54. Estimates by State agencies of amounts needed.— ~~On or before the first day of September biennially in the odd-numbered years~~ *At a time established by the Governor not later than the first day of August biennially in the odd-numbered years*, each of the several State ~~departments, bureaus, divisions, officers, commissions, institutions,~~ *agencies* and other agencies and undertakings receiving or asking financial aid from the State shall report to the Governor, *through the responsible Secretary designated by statute or executive order*, on official estimate blanks ~~furnished~~ *prescribed* for such purpose, an estimate in itemized form showing the amount needed for each year of the ensuing biennial period beginning with the first day of July thereafter. The official estimate blanks which must be used in making these reports shall be ~~furnished~~ *prescribed* by the Governor, shall be uniform and shall clearly designate the kind of information to be given thereon.

§ 2.1-60. Submission of budget to General Assembly.—Within five days after the beginning of each regular session held in an even-numbered year of the General Assembly, the Governor shall submit to the presiding officer of each house printed copies of a budget, based on his own conclusions and judgment, containing a complete and itemized plan of all proposed expenditures for ~~each~~ *the* State ~~department, bureau, division, officer, board, commission, institution, or other agency or undertaking, classified by function, character and object~~ , and of estimated revenues and borrowings, for each year in the ensuing biennial period beginning with the first day of July thereafter. ~~Opposite each item of the proposed expenditures the budget shall show in separate parallel columns the amount appropriated for the last preceding appropriation year, and for the current appropriation year, and may show such other data which the Governor deems of assistance in analyzing the current appropriations and proposed expenditures.~~ *The budget document shall be organized by function, primary agency, and proposed appropriation item. Proposed appropriations shall be structured to incorporate all closely related programs of an agency within a single appropriation; however, the identity of major programs and related costs shall be retained as discrete parts of each appropriation item for information purposes. Opposite each appropriation item and major program the budget shall show in separate parallel columns the amount appropriated for the last preceding appropriation year, the amount expended in the last preceding appropriation year, the amount appropriated for the current appropriation year, and the agency's request and the Governor's recommendation for each year of the ensuing biennial period. Data shall be included by major objects or classes of expenditure at the appropriation level using the same columnar headings as specified in the previous sentence. Summary data of positions authorized and funded or proposed for authorization and funding by the General Assembly shall be shown at the appropriation and program levels, distributed as to type of fund using the same columnar headings as for expenditure data. Any increase in expenditures recommended in the biennium shall be distributed at the program level by (a) cost to continue the present level of activities, (b) costs to process increases in workload, and (c) costs related to new or changed services. A detailed and narrative justification shall be included at the program level organized by the segments (a), (b), and (c) above, and shall include where practicable workload indices and other criteria to be used in both budget evaluation and post audit evaluation. As nearly as practicable for each program there should be included a distribution of the total budget requested as to the portions that are (a) mandated by the federal government, (b) necessary to avoid losses in federal revenues, (c) mandated by Virginia statute and (d) discretionary.*

The Governor shall accompany the budget with:

(1) A statement of the revenues and expenditures for each of the two appropriation years next preceding, classified and itemized in accordance with the official budget classifications adopted by the Governor.

(2) A statement of the current assets, liabilities, reserves and surplus or deficit of the State.

(3) A statement of the debts and funds of the State.

(4) A statement showing the Governor's itemized estimates of the condition of the State Treasury as of the beginning and end of each of the next two appropriation years.

(5) An itemized and complete financial balance sheet for the State at the close of the last preceding fiscal year ending June thirtieth.

(6) A general survey of the State's financial and natural resources, with a review of the general economic, industrial and commercial condition of the Commonwealth.

(7) Statements showing the estimated additional annual costs of the maintenance and the use of each item of capital outlay and the estimated additional annual costs of each new service recommended in the plan of proposed expenditures. The statements shall set forth separately estimates of the number of additional pesonnel and their salaries, and estimates of other costs.

Notwithstanding the provisions of this act, the Governor may elect to delay inclusion of all or part of the data required therein which is in addition to that included in the 1974-1976 biennial budget until the Governor submits the budget for the biennial period beginning July one, nineteen hundred seventy-eight.

§ 2.1-61. Budget bill.—The Governor also shall submit to the presiding officer of each house of the General Assembly, at the same time he submits his budget, copies of a tentative bill for all proposed appropriations of the budget, clearly itemized ~~and properly classified~~ *in conformity with the appropriation structure specified in § 2.1-60 of this chapter*, for each year in the ensuing biennial appropriation period, which shall be known as "The Budget Bill". *Except as expressly provided in an appropriation act, whenever the amounts in a schedule for a single appropriation item are shown in two or more lines, the portions of the total amount shown on separate lines are for information purposes only and are not limiting.* No such budget bill shall contain any appropriation the expenditure of which is contingent upon the receipt of revenues in excess of funds unconditionally appropriated.

Appendix C

Agency Response

As part of an extensive data validation process, the major agencies involved in a JLARC assessment effort are given an opportunity to comment on an exposure draft of the report. Appropriate technical corrections resulting from the written comments have been made in this version of the report.

This appendix contains the Department of Planning and Budget's response to this report.

COMMONWEALTH of VIRGINIA

KAREN F. WASHABAU
DIRECTOR

Department of Planning and Budget

POST OFFICE BOX 1422
RICHMOND, VIRGINIA 23211

November 11, 1991

Mr. Philip A. Leone
Director
Joint Legislative Audit and Review Commission
Suite 1100, General Assembly Building
Richmond, Virginia 23219

Dear Phil:

I appreciate the opportunity to respond to the JLARC report on Virginia's executive budget process. Your review was most timely given the extreme pressures on state budgets in Virginia and across the country.

I am pleased that your review confirmed what many have believed for some time: that Virginia's executive budget process is sound; that budgetary responses to changing revenue forecasts have been timely; that accurate and timely information has been provided to the legislature; and that budget execution is appropriately flexible and complies with legislative intent.

Like all government operations, however, the budget process can be improved, and the management and staff of the Department of Planning and Budget (DPB) are continually refining the process.

Many of the areas your report targets for improvement have been under discussion within DPB for some time. The past two years of budget reduction activities and reduced staff levels in DPB have precluded our making the progress that we had envisioned. Nevertheless, we expect that enhancements will be firmly in place within the next year in the following areas: increased budget training for agencies; greater involvement of agency budget staff in the discussion of statewide budget issues; and increased emphasis on performance measures for state programs.

We are already making strides to address the computing deficiencies noted in the JLARC report. In January 1991, DPB conducted an organizational self-study to determine how agency operations could be made more effective and efficient. A major recommendation of the study was the need for increased analytical capability through enhanced computer technology. In the past six months, we have generated enough savings to purchase seven state-of-the-art personal computers and have upgraded 24 others. When resources become available, we will make additional purchases.

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I would like to comment further on three issues raised in the report: 1) the importance of base budget analysis; 2) the need for a systematic approach to program evaluation; and 3) the improved forecasting of nongeneral fund revenues.

Base Budget Analysis

Although analysis of base budgets occurred routinely in the development of budgets in the 1980s, the scope and depth of analysis has intensified over the past eighteen months. Because this time period was not included in the JLARC methodology, I would like to summarize the components of that analysis.

Beginning in the summer of 1990, DPB and the Governor's Office developed a methodology for reducing agency budgets for the 1990-92 biennium. The first phase involved identifying program exemptions. The Governor indicated that all programs and activities of state government, with a few exceptions, would be examined for savings. Exemptions included those required by law such as debt service, and programs that directly affected the health, welfare, and safety of citizens.

DPB developed reduction targets for each secretarial area and provided secretaries with options for reducing base budgets. Throughout the process, agency officials were the chief architects of the reduction plans, as they should be. Agency directors best know their programs and capabilities, and should be held accountable for program implementation.

During subsequent reduction exercises, the process was generally unchanged. All participants agree that the flexibility given to agencies was the key to achieving needed savings without seriously damaging essential services. In fact, other state budget offices have indicated that they are now implementing our model after statewide directives such as hiring and purchasing freezes had limited success in their states.

As development of the 1992-94 budget progresses, rigorous analysis of the base is underway from policy, program, and fiscal perspectives. DPB analysts are answering the questions posed in the Commonwealth Planning and Budgeting Manual: "1) Is there a need for the program; 2) how can the need be addressed; 3) what is the best way to address the need; 4) how much will it cost to address the need; 5) how will the costs be financed; and 6) what is this program's priority relative to other needs?" We have also undertaken two special analyses that will directly impact base budgets--a review of the positions vacated by the early retirement program, and a comprehensive assessment of state aid to localities.

The knowledge we have gained from these activities will be incorporated in a training module on base budget analysis for all DPB analysts. It is important to note, however, that a rational process for analyzing base budgets such as the six-step plan outlined in the CPBS manual does not always lead to the same budget decision. Inherent in the budget process are the values of elected officials and the citizens they represent. It is entirely possible that a carefully crafted, flawless analysis may lead logically to a budget recommendation that is politically unacceptable.

Program Evaluation

As the JLARC report accurately points out, over the years the numerous and time-consuming statutory requirements for program budgeting have been somewhat relaxed by executive budget officials with the support of the General Assembly. The easing of these requirements was partly in response to the excessive time needed by agencies to complete the budget submission. However, another key factor was the reduced need of legislators for this level of information in the executive budget. With the creation of full-time staff for the House Appropriations and Senate Finance Committees, new sources of information were available. Whereas the executive budget document was the primary source of budget information in the late 1970s and early 1980s, today it is but one of several sources.

One aspect of the original program budgeting design that is essential but not yet fully implemented in Virginia is a formal system of program evaluation. One area where DPB will place additional emphasis is on the systematic examination of program outcomes. During the past two months, DPB staff have developed a list of programs that could be candidates for review. Programs will be selected in conjunction with the Governor's Office, secretaries, and, in some cases agency heads. Legislative staff will also be consulted.

Such examinations may range from routine reviews of planned versus actual outputs of agencies to more complex and time-consuming program evaluations. Regardless of the form of the review, it is critical that the results be shared officially with members of the General Assembly so that they are familiar with the performance outcomes that support increases or decreases in the Governor's budget recommendations.

Nongeneral Fund Revenues

The accurate forecasting of nongeneral fund revenues is critical for executive and legislative officials. The attention paid to nongeneral funds has evolved over the past ten years. As you may know, Virginia did not systematically appropriate federal funds until the 1978-80 budget.

In recent years, we have made strides in reviewing nongeneral fund forecasts. For example, members of the Governor's Advisory Board of Economists review the forecasting models for the Transportation Trust Fund, ABC revenues, and the Unemployment Insurance Trust Fund. We now surpass many states in our analysis of nongeneral funds and their inclusion in the budget bill.

DPB and the Department of Accounts will take appropriate steps to improve the forecasting and reporting of nongeneral funds as recommended by the JLARC report. However, there is no guarantee that these actions will eliminate all discrepancies for several reasons. First, the future course of federal revenue is very difficult to determine. This is because the federal budget does not provide information at a sufficient level of detail to accurately assess the budget impact on many state programs. Moreover, amounts which are allocated to programs by federal agencies are often based on administrative decisions that occur during the execution of the federal budget. In other words, the projection of certain federal items would be nothing more than an informed guess.

Second, the timing of the receipt of funds can be a problem. While nongeneral fund revenues can be accurate in terms of the total amount to be received by the Commonwealth, actual collections can vary from projections depending on when the receipts materialize. This is especially true of private donations and multi-year commitments from the federal government.

Third, workload in nongeneral fund agencies can be different than what is assumed in the budget. For example, there is no cap on higher education enrollment, and if more students choose to attend Virginia's colleges and universities, tuition revenue will vary accordingly.

Finally, some receipts which are treated as revenue for budget purposes may not be classified as such in the accounting system. Transfers of funds between agencies is a good example of this issue.

Other JLARC Recommendations

The JLARC report offers a series of recommendations to the General Assembly, Secretary of Finance, and the Director of DPB. I am in general agreement with those assigned to me, and I will take immediate steps to plan for their implementation.

I respectfully request that as the General Assembly proceeds to implement those recommendations under its purview, that members consult with the Governor and other executive branch officials. This is especially relevant to the recommendation to require a December 15 submission of the budget. As JLARC staff have learned in their review, the executive budget process requires extensive lead time to effect major schedule changes and revise data needs. By working collaboratively on these issues, I believe we can address the information needs of all parties.

I appreciate the considerable time your staff spent with DPB to learn about the budget process. We were invigorated by the opportunity to discuss our business with interested observers, and we look forward to making the executive budget process even more useful for the Governor and for the General Assembly.

Sincerely yours,

Karen

Karen F. Washabau
Director

DPB/D0189
c: The Honorable L. Douglas Wilder
The Honorable J.T. Shropshire
The Honorable Paul W. Timmreck
William E. Porter

Appendix D

Legislation Related to this Report

A BILL to amend and reenact §§ 2.1-224, 2.1-394, 2.1-398, and 2.1-399 of the Code of Virginia *and to amend the* Code of Virginia *by adding a section numbered 2.1-399.1, relating to the budget process of the Commonwealth of Virginia.*

Be it enacted by the General Assembly of Virginia:

1. That §§ 2.1-224, 2.1-394, 2.1-398, and 2.1-399 of the *Code of Virginia* are amended and reenacted and that the *Code of Virginia* is amended by adding a section numbered 2.1-399.1 as follows:

§ 2.1-224. Payments to be in pursuance of appropriations; submission and approval of quarterly estimates.—No money shall be paid out of the state treasury except in pursuance of appropriations made by law.

No appropriation to any department, institution or other agency of the state government, except the General Assembly and the judiciary, shall become available for expenditure until the agency shall submit to the Director of the Department of Planning and Budget ~~quarterly~~ annual estimates of the amount required for each activity to be carried on, and such estimates shall have been approved by the Governor.

§ 2.1-394. Estimates by state agencies of amounts needed. — Biennially in the odd-numbered years, on a date established by the Governor, each of the several state agencies and other agencies and undertakings receiving or asking financial aid from the Commonwealth shall report to the Governor, through the responsible secretary designated by statute or executive order, ~~on official estimate blanks~~ in a format prescribed for such purpose, an estimate in itemized form showing the amount needed for each year of the ensuing biennial period beginning with the first day of July thereafter. The Governor may prescribe targets which shall not be exceeded in the official estimate of each agency; however, an agency may submit to the Governor a request for an amount exceeding the target as an addendum to its official budget estimate. The ~~official estimate blanks~~ format which must be used in making these reports shall be prescribed by the Governor, shall be uniform for all agencies and shall clearly designate the kind of information to be given thereon. The Governor may prescribe a different format for reports from institutions of higher education, which format shall be uniform for all such institutions and shall clearly designate the kind of information to be provided thereon.

§ 2.1-398. Submission of budget to General Assembly. — ~~Within five days after~~ On or before December 20 in the year immediately prior to the beginning of each regular session held in an even-numbered year of the General Assembly, the Governor shall submit to the presiding officer of each house printed copies of a budget, based on his own conclusions and judgment, containing the following:

1. A series of financial statements which set forth:

(a) Revenues and borrowings for each of the following two appropriation years;

(b) Current assets, reserves, and surplus of the Commonwealth;

(c) Debts and liabilities of the Commonwealth;

(d) Itemized estimates of the conditions of the state treasury as of the beginning and end of each of the next two appropriation years; and

(e) An itemized and complete financial balance sheet for the Commonwealth at the close of the last preceding fiscal year ending June 30.

2. A statement of historical and projected trends which influence development, natural and human resources, and general economic conditions in the Commonwealth, and projections pertaining to population, transportation, commerce, agriculture, and urbanization. In addition to utilizing such statement in the preparation of his budget, the Governor shall use such statement for the purpose of coordinating programs of planning district commissions, regional development authorities, and local governments with those of state agencies.

3. A statement of the Governor's proposed goals, objectives, and policies in the areas of:

(a) Administration of justice;

(b) Education, including intellectual and cultural development;

(c) Individual and family services;

(d) Resources and economic development, including specific references to economic development and management of natural resources;

(e) Transportation; and

(f) General government, including therein or as separate categories areas of multiple impact, such as telecommunications, energy, and urban development.

4. A statement organized by function, primary agency, and proposed appropriation item which sets forth:

~~(a) Related programs and sources of funds for appropriation items.~~

~~(b) Current, requested, and recommended appropriations for operating, fixed asset, and debt service expenses.~~

~~(c) Current, requested, and recommended full-time equivalent employment levels.~~

~~(d) Costs to continue present services, and either separately or in combination, the costs to provide for changed and new services.~~

~~(e) Services to be offered, recipients of services, and program measures to be used in monitoring and evaluating services.~~

(a) Identification of common programs and services;

~~(f)~~ (b) Service attainments or lack of attainments and service terminations or reductions for the biennium;

~~(g) Authority for services offered, such as federal or state statute, or a discretionary inclusion.~~

(c) Major goals and objectives for programs;

(d) Program measures to be used in monitoring and evaluating services as specified in the general appropriations act; and

(e) The amount of each primary agency's budget that is direct aid to localities.

5. An "executive salary plan" recommending levels into which the position of each cabinet secretary and administrative head of each agency and institution of the executive branch of state government should be placed for salary purposes, salary ranges for each of those recommended levels, and the basis for the recommendations contained in the plan.

6. A statement of proposed capital appropriations organized by the primary agency that sets forth the program need for the project and the proposed source of funding.

§ 2.1-399. Budget bill. — ~~The~~ A. On or before December 20 of the year immediately prior to the beginning of each regular session held in an even-numbered year of the General Assembly, the Governor also shall submit to the presiding officer of each house of the General Assembly, at the same time he submits his budget, copies of a tentative bill for all proposed appropriations of the budget, ~~clearly itemized in conformity with the appropriation structure specified in § 2.1-398,~~ for each year in the ensuing biennial appropriation period, which shall be known as "The Budget Bill." "The Budget Bill" shall be organized by function, primary agency, and proposed appropriation item and shall include an identification of, and authorization for, common programs and the appropriation of funds according to programs. Except as expressly provided in an appropriation act, whenever the amounts in a schedule for a single appropriation item are shown in two or more lines, the portions of the total amount shown on separate lines are for information purposes only and are not limiting. No such bill shall contain any appropriation the expenditure of which is contingent upon the receipt of revenues in excess of funds unconditionally appropriated. The salary proposed for payment for the position of each cabinet secretary and administrative head of each agency of the executive branch of state government shall be specified in "The Budget Bill."

B. On or before December 20 of the year immediately prior to the beginning of each regular session held in an odd-numbered year of the General Assembly, the Governor shall submit to the presiding officer of each house printed copies of all gubernatorial amendments proposed to the general appropriations act adopted in the immediately preceding even-numbered year session.

§ 2.1-399.1. Capital projects. — A. On or before December 20 of the year immediately prior to the beginning of each regular session held in an even-numbered year of the General Assembly, the Governor shall submit to the presiding officer of each house of the General Assembly, copies of any tentative bill or bills involving proposed capital appropriations, for each year in the ensuing biennial appropriation period. Such bill or bills shall include each capital project to be financed through revenue bonds or other debt issuance, the amount of each such project, and identify the entity which will issue such debt.

B. On or before December 20 of the year immediately prior to the beginning of each regular session held in an odd-numbered year of the General Assembly, the Governor shall submit to the presiding officer of each house printed copies of all gubernatorial amendments proposed to capital appropriations acts adopted in the immediately preceding even-numbered year session.

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(Appendix D Continued)

A BILL to amend and reenact § 2.1-391 of the Code of Virginia, *relating to the duties of the Department of Planning and Budget.*

Be it enacted by the General Assembly of Virginia:

1. That § 2.1-391 of the *Code of Virginia* is amended and reenacted as follows:

§ 2.1-391. Duties of Department. — The Department shall have the following duties:

1. Development and direction of an integrated policy analysis, planning, and budgeting process within state government.

2. Review and approval of all sub-state district systems boundaries established or proposed for establishment by state agencies.

3. Formulation of an executive budget as required in this chapter. In implementing this provision, the Department of Planning and Budget shall utilize the resources and determine the manner of participation of any executive agency as the Governor may determine necessary to support an efficient and effective budget process notwithstanding any contrary provision of law.

4. Conduct of policy analysis and program ~~analysis~~ evaluation for the Governor.

5. Continuous review of the activities of state government focusing on budget requirements in the context of the goals and objectives determined by the Governor and the General Assembly and monitoring the progress of agencies in achieving goals and objectives.

6. Operation of a system of budgetary execution to assure that agency activities are conducted within fund limitations provided in the appropriations act and in accordance with gubernatorial and legislative intent.

7. Development and operation of a system of standardized reports of program and financial performance for management.

8. Coordination of statistical data by reviewing, analyzing, monitoring, and evaluating statistical data developed and used by state agencies; by receiving statistical data from outside sources, such as research institutes and the federal government ~~; and by receiving and approving the initiation of new statistical data programs.~~

9. Assessment of the impact of federal funds on state government by reviewing, analyzing, monitoring, and evaluating the federal budget, as well as solicitations, applications, and awards for federal financial aid programs on behalf of state agencies.

10. Review and verification of the accuracy of agency estimates of receipts from donations, gifts or other nongeneral fund revenue.

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