limited, so complexity provides minimal improvement over the simple growth rates. You will learn more complex forecasting methods in a later chapter about revenue forecasting, but you will use simple forecasts like these most often when you are developing and analyzing the expenditure sections of an annual budget. Just don't use growth rates to create your expenditure requests directly (i.e., spending has grown at a rate of 3 percent over the past five years so I will just add 3 percent to spending this year to get the spending request). That means that you haven't a clue about developing an action plan for your agency but are simply willing to go with the flow and aren't actually doing your job. Forecast the operating conditions, then develop your spending proposal around your planned response to those conditions.

## Preparation of Agency Budget Requests

Operating agencies work from the budget instruction transmitted by the central budget office to develop their operating plans for the year and the budget requests that will accommodate those plans. Ideally, the instructions provide (1) the chief executive's main goals for the people, (2) forecasts of critical operating conditions for the budget year (inflation, service populations, etc.), (3) a format for the budget proposal (usually including prescribed request forms), (4) a schedule to be followed in developing the budget, and (5) some indication of the amount of money that the agency ought to build its budget around (either a ceiling control total or an estimated maximum increase from prior years).

How do the chief executive and central budget office know whether the instructions to agencies should emphasize extreme fiscal constraint, allow modest expansion of existing programs, or permit consideration of sound new programs? Many governments prepare, as a starting point, a preliminary baseline forecast of the surplus or deficit. The baseline provides the projected budget conditions if policies embedded in existing law are maintained.[1] In this analysis, the budget office forecasts revenue for the budget year and compares that forecast with the cost of continuing existing programs at their current level of operations under the conditions expected for the next year (prices, workloads, etc.). In many instances, the simple projection approaches presented earlier in this chapter are used, although sometimes more complex forecasting models may be applied. The gap, either positive or negative, between revenue and expenditure under current law gives a first guidance for the budget instruction: Will agencies be allowed to propose new programs? Will they work under hiring freezes? Will they be constrained in their capacity to request new equipment or to make capital outlays? What sort of ceilings will they face in making

[1]Establishing exactly what the baseline should entail is not without controversy. See Timothy J. Muris, "The Uses and Abuses of Budget Baselines," in John F. Cogan, et al., eds., *The Budget Puzzle, Understanding Federal Spending* (Stanford, California: Stanford University Press, 1994): 41–78. The argument concerns what exactly current policy should mean.

their requests? How the chief executive feels about deficits and surpluses and whether that executive is willing to propose revenue increases (tax or charge increases) also shape the instruction.

A good place for the agency administrator to start her budget development, along with making sure she understands what the chief executive wants, is to reflect on where the agency's operations have been in the recent past and to consider where she would like the agency to head in the near future—three to five years, with more attention to the near years than to the distant years. This reflection provides, along with the instruction, the basis for creating the service policy that will shape her budget proposal. After she gets into the numbers, it will be too late to do much policy reflection and revision, so she should start by thinking.

Within that instruction and service intention the agency develops the three important pieces of its budget proposal: (1) a *narrative,* which describes the agency (mostly the same from year to year), indicates its managerial objectives for the budget year and beyond (probably changing from year to year), and is keyed to the agency mission statement; (2) *detail schedules,* which translate the managerial objectives into requests for new agency appropriations; and (3) *cumulative schedules,* which aggregate the new initiatives into existing activities to form the complete request. The presentation also probably includes *workload, productivity,* and *performance measures* for the agency. The workload identifies measurable activities of the agency with historical trends and projections for the future. Productivity relates these workload measures to numbers of personnel, and performance measures identify quantity and quality of service delivered to the public, sometimes including the results of citizen satisfaction surveys (a later chapter will discuss the use of performance indicators in the budget in some detail).

The most important lesson for the neophyte to learn about budget preparation, and possibly the most surprising, is that description dominates the numbers. The request must describe and justify the plan; the numbers follow from that. Budgeting is logic, planning, justification, and politics, not mathematics or accounting. The narrative, detail schedules, and cumulative schedules are all critical because they provide governments the "how much" and "what it does" information needed for successful public decisions. The whole process begins with the agency's explanation of what it intends for the budget year. The narrative explains the policy response that the agency has decided to make in response to what it believes to be the operating conditions it will face in the budget year. The basic rule: "The words come before the numbers." When the words (the narrative) are clearly provided, the numbers fall easily out. An agency administrator who builds his or her budget request by projection of historic patterns of expenditure categories is not serving the public well and really does not understand the job.

Agency budget documents are likely to include details not just on how money has been and is intended to be spent, but also on agency performance and accomplishments. It is a reasonable expectation that an agency be able to explain what it has done with the money—besides spend it!—and to explain what the public can expect to receive from the planned operations of the agency in the upcoming budget year. This performance information and these plans may be embedded as an important element of the budget narrative but, increasingly, the budget proposal has a distinct and identifiable section that deals with performance. Central administrations, legislatures, and the citizenry all seek performance information as they consider budget requests and operating plans of public agencies.

## *Budget Justification*

Program status reports, requests for supplemental funding, supporting explanations for increased staff, budget increases, and so on, require justification for any planned agency action. Well-developed justifications are the key to successful agency budget requests.[2] The standard rules of English prose apply, but there are also several general and specific guidelines for effective budget justifications.

**1.** The justification must avoid jargon and uncommon and unexplained abbreviations because its audience includes individuals less familiar with the details of the proposed activity than the operating agency's personnel. Neither budget-agency examiners nor legislators are likely to approve poorly described projects. Never create your own acronyms. The justification should follow the basic standards of expository writing: short sentences, short words, active voice, no footnotes, and eliminate unnecessary words.[3]

**2.** The justifications must be factual, provide documented sources, and go through ordinary review and revision to produce a polished presentation. Some of the justification may be technical; however, the technical parts cannot overwhelm the rest or be left unexplained. The justification has to focus on the small number of points that the reader should pay attention to and remember.

**3.** The justification structure must address the current situation, additional needs, and expected results from honoring the request. One section of the justification should describe the current program in terms of measurable workloads, staffing, funding, or productivity trends. It should briefly and specifically inform the budget examiner of existing conditions, without extraneous detail that might misdirect the examiner's attention. Another section of the justification should describe the additional needs. It must specifically identify additional funds, personnel, and materials needed for the budget activity at issue. The reason for the need must be explicitly developed. The examiner must not have to guess what and why.

**4.** The request must indicate what beneficial results will come from granting the request. It must make clear that something important will be made better if the requested activity is carried out and that the agency has the capacity to carry it out.

The details of what belongs in the justification are ordinarily covered in the instructions. Hence comes the basic rule for doing budget justifications: *read the*

[2]They are also critical for grant proposal writing for public and nonprofit organizations.
[3]Be a Hemingway, not a Faulkner.

*instructions and follow them.* If the instructions leave you with any uncertainty about what the justification should include, you won't go wrong by explaining (1) what resources the agency wants for the budget year, (2) what it intends to do with those resources, and (3) what good will result from that intention.

Common reasons for requesting funds include the following:

**1. Higher (or lower) prices.** Prices of supplies and services needed to maintain agency operations at their existing level may be increasing (or decreasing). For instance, the local electric utility may have received approval for a rate increase during the next year. That could elicit a request for a budget increase to accommodate the increased cost of the service.

**2. Increased demand for service (workload).** The clientele served by the agency may increase. To maintain service levels, the agency's budget may need to increase. An agency providing education to children of the homeless, for instance, could argue for a larger budget if the population of such children is expected to increase.

**3. Methods improvement.** Administrative changes or innovations can alter the budgets of agencies. An operating unit can become more productive and generate fewer errors if it has more space, if it has more modern equipment, or if it has better information technology. That would require a budget request. Methods improvement can also allow savings, in which case the budget change would be negative. Some improvements may have been mandated, or required by the courts, the legislature, or a higher level of government.

**4. Full financing.** Agencies frequently start new operations at some point other than the start of a fiscal year. Initial appropriations for new operations are thus partial; to cover full operations would require larger appropriations, a change that needs to be described in the agency request.

**5. New services.** New services, enlarged services, improved services, or services to an expanded clientele should be identified and justified. Because new services would not have been previously considered in legislative deliberations, they do require separation in the budget. New services are likely to be closely linked to initiatives in the basic narrative. As with method improvements, some new services may have been mandated.

There may be other categories of justification that would be applied to allow agencies to identify the underlying case for their request. For instance, some federal agencies recognize a judicial restraining order as a separate category. Those noted here, however, are among the most common.

The narrative should describe expected results from the proposal and try to convince the budget office and the legislature of the need for the proposed activity. The narrative should describe the consequences if the requested resources are or are not provided. Because the reviewer will want to know whether partial funding will help, whether critical program objectives will be endangered without funding, whether workload can be backlogged to get around the problem, and what the implications of the request will be for future requests, answers to those questions should be available and defensible. The justification should make a solid case for a realistic increase.

**Table 4–1**
**Checklist for Budget Justification**

| | |
|---|---|
| Completeness | —Are the major elements (objective of program, magnitude of need, benefits, or accomplishments) covered? |
| Explicitness | —Are program benefits and related funding increases clearly stated? |
| Consistency | —Are the statements or data appearing in several places the same or easily reconcilable? |
| Balance | —Are the most important programs and issues given the most prominence? Do the programs' objectives adequately support the budget level requested? |
| Quantitative data | —Are quantitative data used appropriately and effectively? |
| Organization | —Is the material well organized to bring out only the significant matters? Are appropriate headings or titles used? Is introductory or summary material used appropriately? |

*SOURCE:* U.S. Office of Personnel Management, *Budget Presentation and Justification* (Washington, D.C.: GPO, 1982).

There is no reason to spread a justification thin to defend a large increase when a solid case for a smaller increase is possible. Table 4–1 presents a brief checklist for elements to include in a sound justification. An agency should never assume that its request for additional resources, no matter how reasonable it may appear to agency staff, will automatically bring more funds. When an agency does not receive its full budget request, the agency cannot complain that it has not been "fully funded." Its legislative masters, the representatives of the citizenry, have not agreed to the plan proposed by the agency but it has fully funded the plan that it has accepted. The agency is expected to execute the plan that has been accepted.

## *Elements of Cost Estimation*

Estimates of what the cost would be of fulfilling the agency service plan for the budget year may be developed and organized through one or more of the following classification structures. First, the cost may be grouped by the organization (branch, section, division, etc.) incurring the cost. The estimates originate in the offices where the costs occur. The costs thus follow the organizational chart. For example, if a city has six organizational units (police, fire, parks, public works, streets, and mayor and council), a cost estimate would be prepared for each unit. The estimates would entail each unit's planned responses to forecast operating conditions. Some plans and forecasts would ideally be common, that is, everybody has integrated into their plans the closing of a military establishment on the edge of town. But some plans would impact almost exclusively one department, for example, the street resurfacing program matters for the streets budget but not for the others. Second, costs may be grouped by task, purpose, function, or program cost center, or by program outcome group. For instance, program cost centers for a police department might include central administration, the jail, criminal investigations, crime prevention, traffic, training, communication, and records. Each represents an identifiable task for which operating plans and budget cost can be identified. Alternatively, cost may be divided by outcome program: transportation, public safety, environmental protection, and so on. Sometimes the organizational breakdown coincides with these task or program breakdowns, but often organizational costs are attributable to several different tasks or programs. Third, the costs may be broken down by object (or economic) class, that is, by the nature of goods and services to be purchased (personnel, utilities, motor fuel, etc.). Agencies organize their cost estimates according to the uniform object classification required and provided by the budget office of that particular government.

The beginning of any budget cost estimation, regardless of eventual focus on department, task cost center, or program outcome, is the object class. This is the basis for estimating resource requirements, regardless of how costs will eventually be organized. Ideally, the agency would determine what it intends to do, determine what resources it needs to do it, estimate the price of those resources, and multiply the price by the number of input units to get a cost total. In routine budget preparation, some of the estimates for smaller input categories are based on what the agency has experienced in the recent past ("last year plus 5 percent," for instance, implicitly says we aren't changing our operating plan and costs of inputs associated with that plan haven't changed very much). Budget costs occur as agencies acquire resources (personnel, materials, and facilities) to provide public services. Somewhat different estimating techniques apply to each class, with a particular distinction between personnel and nonpersonnel costs. The agency is always working toward estimating the cost of carrying out the plan described in the narrative.

## *Personnel Costs: Paying the Staff*

Agencies need workers if they are to produce government services or, even if production is contracted out to private firms, to monitor this production by others. Indeed, payments to employees—wages and salaries plus other agreed benefits (pensions, insurance, etc.)—usually represent the largest single component in government agency budget requests and a major element in the total cost of government. For instance, compensation of employees amounts to more than 70 percent of state and local government consumption expenditures, with some agencies even much more labor intensive. A considerable portion of the total cost of modern government is determined by compensation paid to employees, even though the wage and salary component of spending has declined through the years as governments provide more services by contract with private firms and by transfer payments and as they substitute technology for personnel to improve service quality and constrain cost.

## Wages and Salaries

The task is to estimate personnel cost for a budget request: to determine the kind and amount of personnel services needed (established by agency planned response to forecast operating conditions)—the time to be spent by employees at work—and then apply prevailing wage and salary rates to compute the total cost. In other words, total personnel cost equals the number of workers in each pay category multiplied by the payment per worker in that category. A standard procedure uses personnel data on individuals in each pay category, adjusted for anticipated movements to the next pay step in the budget year. Thus, if there are 50 people in the Tax Auditor I category with five years' experience this year, there will likely be 50 people in the Tax Auditor I category with six years' experience next year, assuming the tax department plans about the same operating pace as in the prior year. The budget estimate for them would be 50 times the annual pay of a Tax Auditor I with six years' experience. Governments normally maintain a position management system that charts authorized positions by pay class, which positions are filled and which are vacant, and the pay rate in each class. The system both provides a control over employment and its costs and offers an excellent tool for cost estimation.

The request for payment of staff must be supplemented by lapses that reduce total cost: turnover (retirements, quits, and terminations) with replacement at lower pay grades or nonreplacement, delays in filling vacant positions, and so on. Such lapses may be estimated from experience with the agency workforce. Requests for new personnel ordinarily are based on greater expected workload, on a desire to improve the quality of service, or on new programs. At least at the agency request level, staffing decisions have moved away from regarding government as the employer of last resort, where those unable to find jobs elsewhere can turn, and toward staffing to ensure the agency delivers planned services and achieves its objectives.

But how much should each employee be paid? This question is critical for sound government finances and for the delicate political balance between, on the one hand, the interests of public employees and the groups that represent them and, on the other, the concerns of taxpayers/service recipients who both receive what governments provide and pay the bill for that provision. A reasonable objective in determining pay rates for government finances might be to ensure delivery of government services at least cost to the taxpayer. If employees are overpaid, the taxpayer pays too much for services provided; if employees are underpaid, the taxpayer receives subsidization at the expense of those employees. In practice, pay rates may come (1) from law or tradition, as with the salaries of elected officials, (2) from pay rates established in a civil service classification structure that attempts wage-comparability across position factors, or (3) from collective-bargaining agreements.[4] Most governments establish some salaries in each of these ways. For example, a city could well have the salaries of the mayor and the members of the council established

[4] See Charles A. Pounian and Jeffrey J. Fuller, "Compensating Public Employees," in James Perry, ed., *Handbook of Public Administrations,* 2nd ed. (San Francisco: Jossey-Bass, 1996), for more discussion of pay systems.

by state statute, the wages and salaries in most city departments established in a personnel classification system, and the wages of police officers, firefighters, and sanitation workers established in a collective bargaining agreement.

### Non-Wage-and-Salary Personnel Costs

The total cost of workers includes both direct compensation (wages and salaries) and fringe benefits associated with employment. At least some fringe-benefit payments are included in object classes separate from wage and salary payments, but they must be considered when estimating total compensation and when developing budget estimates. These payments may include payments into public employee pension systems, health and/or life insurance premiums, clothing or uniform allowances, employer Social Security or other payroll tax payments, and so on. Most such benefits are computed by applying formulas, which are established by law, labor contract, or (less frequently now) prevailing practices. Cost is normally driven either by the number of employees (hospital insurance premiums, for example) or the amount paid to employees (e.g., payments into a public employee pension fund based on a certain percentage of wages). Calculation is thus relatively straightforward (although the formulae can sometimes be quite complicated). Some costs associated with employing workers may be in budgetary accounts other than those of the agency in which the person works. For example, the government may put employee benefits (pensions, vacation pay, etc.) in the budget of a Department of Personnel. That complicates the work of analysts who are trying to discern how much a government is spending to provide a particular service—looking at the spending in the police department will not provide the whole answer if some police officer benefits are being covered by the personnel department budget.

## *Nonpersonnel Costs*

Other object costs may be more difficult to estimate than personnel costs.[5] Nonpersonnel costs are often computed using estimating ratios, as adjusted by recent experience. Much information for the request can be located in prior-year budget materials. Five estimation techniques are frequently used in these computations:

**1. Volume × unit price.** This method is attractive when an identifiable quantity and a single average price are applicable to a relatively high-ticket object class. Candidates for this approach include requests for items such as automobiles or personal computers. These items represent fairly homogeneous categories that can constitute a large share of cost in an object class. If the police department plans to purchase 10 new vehicles, each of which would likely cost $35,000, the estimated cost of the plan is $350,000.

[5] See Susan A. MacManus, "Designing and Managing the Procurement Process," in Ibid., for an excellent analysis of the procurement of goods and services.

**2. Workload × average unit cost.** This approach uses recent cost experience with adjustments for changed plans, inflation, or productivity changes. For instance, food expenses for a training class could be estimated by such a method (300 trainee days at $20 per trainee day, for a request of $6,000).

**3. Workforce ratios.** Some categories of cost, particularly small categories of miscellaneous costs, can be estimated by relating them to the workforce. For example, office supply expenses for a revenue department district office could be related to the size of staff stationed there. A proposal to hire new police officers may bring with it the need to purchase new police vehicles. (Similar estimates can be made by linking the expense category to the clientele being served by the local office.)

**4. Ratios to another object.** When there is some relationship between certain categories and other resources used in the production process, that expense group can be estimated by use of ratios to the nonpersonnel object class. As an example, a parts inventory for motor vehicles can be linked to the number of vehicles in the motor fleet. Purchase of 10 new police vehicles would require some additional costs for operation and repair.[6]

**5. Adjustment to prior-year cost.** Small, heterogeneous cost categories can be estimated by adjusting prior-year lump sums. Prior cost is adjusted to reflect anticipated quality changes in the budget year. This method may be necessary when other means are not feasible or economical, but it lacks the attempted precision of other techniques.

No formula or ratio can be automatically applied without hazard. Cost ratios and other relationships may change if operating methods are altered, prices of inputs change, or production technologies change. All of these change in a dynamic economy, often with great impact on operating cost. Sidebar 4–1 describes break-even analysis, an estimating device often used by managers in public, private, and nonprofit agencies as they develop fiscal plans.

## *Screening for Errors*

Budget estimates must be carefully prepared because the quality of the presentation shapes the impressions that budget analysts (and others) develop about agencies. Analysts are less likely to trust judgments of budget officers who prepare sloppy budget requests. Several simple errors are particularly frequent, although they should never occur. The budget should not be transmitted outside the agency until a check

[6] Sometimes things do not work out well. For instance, a federal judge ordered LaPorte County, Indiana, to remedy chronic jail overcrowding, and the county spent $23 million on a jail renovation and expansion, completed in 2004. Unfortunately, the county did not have enough money to hire additional jailers, so a new wing with space for 200 inmates had to remain empty. Too bad the judge did not order jailers to accompany the jail space.

## Sidebar 4–1
## Break-Even Analysis

Break-even analysis is a helpful tool for certain managerial problems, including budget estimation, subsidy determination, scaling, and the like. Agencies that have sales revenue can make more frequent direct use of the technique, but most managers will find some applications. The technique plots cost against revenues as the quantity of service (output) provided varies. That allows the manager to identify the service level at which service revenue equals service cost (the break-even point) and the required subsidy or contribution (profit) at other operation levels. With the costing model developed here, a budget administrator can easily see how changing demand for a service will influence the agency's spending pace, and that can be useful in both developing a budget request and monitoring spending within budget execution.

The logic of the method is illustrated with this example. Suppose the Smithville Solid-Waste Management Authority has a trash collection fee of $2 per 40-gallon container; that means its revenue in a particular time period will equal the number of containers of trash collected multiplied by $2. Algebraically,

$$TR = P \times Q$$

where $TR$ equals total revenue, $P$ equals price per unit, and $Q$ equals the number of units or service level. Thus,

$$TR = 2Q$$

The authority faces two types of cost, some that are fixed (they do not change with the quantity of service provided, at least within normal service ranges) and some that are variable (the cost increases with the level of service). Authority estimates show the following costs:

| Fixed (Annual) | |
|---|---|
| Administration (staff, utilities, etc.) | $ 35,000 |
| Equipment lease | 85,000 |
| Total | $120,000 |
| **Variable (Per Container)** | |
| Landfill tipping charge | $1.00 |
| Equipment operation on collection routes (fuel, maintenance, etc.) | 0.15 |
| Collection crew payment | 0.25 |
| Total | $1.40 |

An algebraic statement of total cost would be

$$TC = FC + (VC \times Q)$$

(continues)

**Sidebar 4–1 (continued)**

where $TC$ = total cost, $FC$ = fixed cost, and $VC$ = unit variable cost. Thus,

$$TC = 120{,}000 + 1.40Q$$

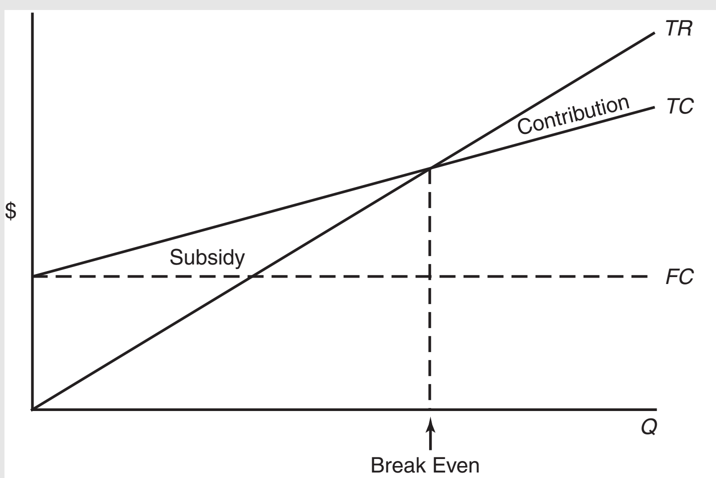
The authority can now estimate the level of collections at which the operation will break even and, probably more important, the necessary subsidy at actual levels of operation. The break-even service level is the one at which $TR = TC$:

$$2Q = 120{,}000 + 1.40Q$$

The break-even $Q$ is 200,000; collection levels above that will provide a surplus (or contribution) for use elsewhere, and collection levels below that will require a contribution from elsewhere (maybe a tax?) to cover the cost. By substituting the manager's best guess for actual service level into the equation, the actual contribution or subsidy requirement may be estimated. The analysis can also help the manager identify the relative impact of controlling fixed or variable cost in reducing the overall subsidy requirements.

Managers need to recognize the limitations of the analysis, even as they use it. Costs may be difficult to estimate and may not be easily divided into fixed and variable. There may also be cost discontinuities. In other words, certain costs may be fixed up to some production level, but need to increase to support further service production. Service levels almost certainly vary with the price charged, especially with larger price changes. The assumption of linearity can only be seen as a working approximation. The technique, however, remains one of great applicability.

Managers often develop break-even charts to visualize their operations. The charts plot total cost and total revenue against service (or output) levels, as shown here:



has been made for the following errors, because these errors will be the first things that the central budget examiner will look for:

**1. Instructions not followed**: Budgets may not coincide with current budget instructions, budget guidelines, and forms. A budget may be developed using the prior-year budget as a guide, but the submission must coincide with current regulations. Failure to follow instructions produces needless embarrassment and may put the request at extra risk.

**2. Missing documentation.** Budget submissions may lack required supplemental documents or the documentation may not be properly identified. Budget examiners are not inclined to give the benefit of the doubt to budgets with missing materials.

**3. Internal inconsistency.** Cost-estimate detail columns may not add to totals carried forward in the presentation. One must continuously cross-check to preserve the internal consistency of the budget request.

**4. Math.** The math may not be right. Failure to check all calculations can lead not just to professional embarrassment but also to rejected budget requests and to terminated employment. Even spreadsheet calculations need to be verified to ensure that formulae do what is expected and that the formulae are right. The computer does exactly what it is told to do, even when you tell it to do the wrong thing.

## Review of Budgets

Agency requests are reviewed by a central budget office before proposals are included in the executive budget (and by legislative committees after inclusion in the proposal). The central budget office is working under a total resource constraint—revenue forecast to be available in the budget year, funds to be borrowed during the budget year, and any balances forecast to be available from prior years—and the sum of all executive budget requests must be within that constraint. In almost every circumstance, the sum of requests is more than the money available to spend—so the central budget agency is going to have to reduce some requests. But the budget agency is also concerned that the budget and operating plan finally approved can actually be executed. That means that it may need to add omitted items from some requests if the examiner finds that a program supported by the chief executive cannot be executed with the resources initially proposed by the agency. Furthermore, the budget examiner is less-informed about agency operations than are those in the agency who prepared the budget. That means that the budget must clearly communicate and explain what is in the budget proposal.

How do budget examiners review budgets? In many respects, the budget examiner will "reverse engineer" the budget proposal, to get behind the gross numbers to see what is driving them, to see what policies are being implemented, to see what environmental forecasts are involved, and to see what the internal logic of the proposal actually is. The examiner will have the budget narrative as a roadmap, but will deconstruct the numbers to make sure that she understands how the service delivery plan works and how that matches the narrative. The examiner will be less knowledgeable about details of the program under review than those who run the program, but will not be uninformed and powerless to review. Some of the work is background and Appendix 4–1, instructions to Oregon budget analysts, gives a good overview of what work must be done and how a budget examiner would proceed with the review task.

Agency budget requests will often be analyzed twice within the executive branch. First, an analyst within an agency is looking to bring forward a request that best reflects the program of that agency and stands the best chance of ultimately being approved and executed. The objective is to produce the best case for the agency's proposals against those from other agencies. Second, an analyst within a central budget office is reviewing a request to ensure that it best reflects the program interests of the chief executive and, if approved, can be executed as intended. Both examiners ultimately have the interests of the public as their objective but their particular twist on the analysis will be slightly different, as you can appreciate.

## *Reviewing a Budget Request*

A budget reviewer will go through several steps in the analysis of a department or division budget. The materials used in the review will include (1) the budget instruction under which the budget proposal has been prepared (chief executive priorities, ceilings, standard price increase for categories like motor fuel that are purchased by many departments, etc.), (2) the narrative for that agency, (3) the budget request numbers for the agency, (4) prior year budgets and appropriations to that agency, and (5) a report of execution of that budget for the current year (budgets are always being reviewed in the midst of budget execution and those reports give useful information about the budget proposal because the execution gives the freshest fiscal information about the agency—a first review step is to determine whether the current pace of spending will use up the appropriation and whether what is found is consistent with the budget request).[7] With those information sources, the analyst considers these questions:

**1. Policy.** The reviewer must consider what the policy rationale is for the agency's proposal. Among the questions to be considered are these: Is the problem real? Is the problem something that this government should be doing something about? Is the strategy that the agency is proposing likely to be successful? Will the program make any difference? What is the chief executive's view on the policy under consideration? Does the narrative reflect the chief executive's expressed priorities?

[7] In other words, if the budget request is being analyzed with three months left in the fiscal year, divide actual spending by the agency to date by 9, multiply by 12 and see whether the resulting number is considerably above or below the appropriation. If it is considerably below, is the budget request for the next year reduced and, if not, why not? At least ask questions about the request on the basis of the comparison.

If not, it is unlikely that the chief executive will want the budget transmitted for legislative approval to be heavy on that sort of proposal. The analyst would normally check with the agency to see whether or not it might want to try again, no matter what the submission timetable was.

**2. Arithmetic.** The math gets checked again. The reviewer must verify the arithmetic used to produce program requests. Errors and overambitious rounding seem to increase requests more often than they reduce them.

**3. Linkages.** Reviewers should check linkages between justifications and dollar requests. Is there reason to believe that the request will have the expected result, or will things stay about the same, regardless of the money requested? Requests in the latter category are good candidates for elimination. Does the budget narrative get reflected in the budget request? Suppose the police department narrative emphasizes a new program that moves the police out of cars and onto bicycles as a program of heavier engagement in the community and of environmental sensitivity. If that is there, the analyst would look for bicycles in the budget and maybe for less motor fuel. The words need to be reflected in the numbers because the words establish the intended policy response to the expected service environment.

**4. Agency competence.** Does the budget request suggest that the agency understands what is going on? If the request appears to have been prepared by an extrapolation or projection of expenditure categories in prior years, then the agency administrator is either lazy, inept, or has no understanding of the process of providing the assigned service. This person is officially a wiener and it is the job of the budget examiner to roast him or her. Projections of prior growth do not make a legitimate budget request—no policy, no expectations about operating conditions, no idea how the agency fits together.

**5. Spending drivers.** Figure out what drives the budget and make sure that relationships are reasonable. For instance, many city police department budgets are driven by cops and cars—those two inputs, and inputs closely associated with them (e.g., motor fuel and fringe benefits) create much of the budget and changes from one year to the next. The budget analyst needs to ensure that changes in these critical inputs are consistent with the narrative and that internal relationships between these inputs are reasonable. For instance, is the police budget request being manipulated by a change in the established replacement cycle for police cars? If so, is this a reasonable and conscious policy or is it simply an attempt to kick the problem down to later years? Agencies will differ in terms of what the drive inputs are—a city water utility is likely to have different critical inputs than the city police department, and the U.S. Department of Defense will be completely different. Part of the reverse engineering that the budget examiner does will involve identifying the major spending drivers.

**6. Omissions.** The reviewer must seek omissions from the budget requests. Some years ago, a major university constructed a large center for performing and creative arts but neglected to request money to cover electricity and other utilities needed for its operation. That created significant budget problems during the first year because major reductions had to be imposed on other university activities to cover that utility bill. The reviewer should also consider whether the agency is planning to mix capital funds with operating funds.

**7. Ratios, shares, execution, and trends.** The reviewer must use all resources available for analysis, particularly the prior-year budget and actual expenditure, the current-year budget and reported expenditure to date, and the proposed budget. A comparison of these documents can be made without undue trouble, especially since the analyst has been keeping track of the agency through the operating year. The analyst should establish the cause of any deviations from trends apparent in those comparisons. The analyst often computes ratios and shares of cost elements over time and across agencies to identify variances and to raise questions for the agency (Sidebar 4–2 discusses ratios and shares in greater detail). Ratios, shares, and trends seldom answer questions by themselves, but they do frequently open up matters for further inquiry. Compare the budget request with the request and appropriations for previous years and, crucially, with the execution report for the current year. Are there significant changes in trends and relationships between inputs and programs and are any changes explained in the narrative? Are changes based on different service policies or on changing prices for inputs? Are certain input categories likely to be underspent or overspent this year, based on the execution reports, and is there a reasonable adjustment in the budget request?

**8. Choices within limits.** The reviewer must understand that resources are finite and choices must be made among worthwhile programs. Government programs to improve adult literacy and programs to reduce fatalities at rural intersections both yield a return that is important for society. But if government resource constraints prevent both programs from being included in the executive budget at the full amount requested by the operating agencies proposing them, a choice has to be made between the two—and there is no common denominator (a social value "converter" between more literate adults and fewer deaths in the country) between the two programs. The choice will be fuzzy, imprecise, and somewhat discomforting. But it is a choice (one of many) that has to be made. Also, if the request involves moving some activities to outside contractors or moving some previously contracted activities back into the agency, the reviewer needs to question the reason and the justification to see whether performance improvement or cost reduction has been sufficiently demonstrated (movements in and out are costly, so they should not be done on whim).

**9. Performance.** The reviewer considers the performance documentation provided by the agency, the extent to which the measures provided are consistent with the mission and goals of the agency, the extent to which accomplishment is appropriate to the budgetary resources available to the agency, and the performance plan related to the budget request of the agency. It is important to consider the extent to which measures are germane to the

## Sidebar 4–2
## Ratios and Shares

Management guru Peter F. Drucker writes, "A database, no matter how copious, is not information. It is information ore. For raw material to become information, it must be organized for a task, directed toward specific performance, applied to a decision. Raw material cannot do that itself."[1]

Budget documents provide a rich lode of data about agencies, but those data are raw. Budget analysts regularly calculate ratios and shares from that data to convert it into information that might help make a decision. For example, it may be interesting to know that East Liverpool spends $400,000 on police salaries, but real insight requires the number to be related to something, often through a ratio or a share. What ratio or share might help, given the considerable array of possible computations that could be made? Here are some fundamental data questions:

1. What period-to-period increase or decrease appears in the categories being examined? What reasons induce the changes, and are they likely to continue in the future?
2. What are the growth rates of elements in the budget totals? Which categories are driving the overall growth, what appears to be causing those patterns, and what are the prospects for the future?
3. What are the shares of individual budget elements in the total? Are particular shares growing rapidly? What are the trends? What components are most significant in the overall budget?
4. How large is the element under consideration, relative to the entity under consideration? Is it big, considering the economy, population, geography, or whatever else may be important?

Ratios and shares do not, by themselves, answer analytic questions, but they can highlight avenues for further inquiry. The analyst spends much time computing them and deducing what additional questions need to be asked. Much of the effort involves comparisons of ratios across units and across time. There will be no "right" value for a particular ratio. Rather, the ratios provide clues that may open avenues of understanding for the analyst and decision-makers.

[1] Peter F. Drucker, "Be Data Literate—Know What to Know," *Wall Street Journal,* 1 December 1992, A-16.

mission of the agency, and extend beyond just measuring things that are easily measured. Poor performance may, if the work of the agency is sufficiently important to the citizenry, provide a reason for increasing the budget of the agency, rather than for cutting its budget. It is expected that there will be a link between achievement of the performance measures and the implementation of the budget.

The reviewer is examining the budget request as representative of the chief executive and of the taxpaying/service receiving public. The objective is not to irritate the person who prepared the request, although that may happen along the way, but to make sure that planned services get provided as effectively, efficiently, and economically as possible.

## The Budget Presentation

Although the budget has been presented in written form, agency administrators usually will need to make a formal, oral presentation of the budget to a budget policy committee, a legislative group, or others. There are varying degrees of formality to the presentation and of tension associated with the event. In many instances, the group to which the budget is being presented, while well-meaning and serious, has no idea what is going on and what the budget issues actually are. It is wrong, however, for the administrator to do anything other than take the presentation as completely serious. The administrator should prepare as if the survival of the agency vitally depends on the outcome of the meeting, even if it is likely to be entirely pro forma.

The presentation should provide an overview of what the budget is about, in particular, how each segment contributes to the fundamental objectives of the organization. It should direct special attention to the larger elements of the budget, even though nonexperts will feel more comfortable in discussing smaller items. The administrator's objective in the presentation is to bring the committee into support of the agency budget and that includes support for the large elements, even though their understanding may be somewhat imperfect. In many respects, the administrator seeks to teach the committee about the agency, its reason for existence, the things that it intends to achieve, and how the budget works to reach those objectives.

Some administrators take a hide-and-seek approach with their budget presentations. In other words, there are problem areas in the budget request but the review committee will have to find them on their own if they can. An alternate approach is entirely opposed to this. The administrator directs the attention of the committee to the problem areas and then takes the offensive in terms of building the agency view (or spin) on the topic. In this approach, the agency position sets the standard, establishes the environment, and draws the boundaries for the committee discussion. Many administrators are more comfortable with this approach and find it to be extremely useful. It also has the advantage of better following the governance principle of transparency than does the hide-and-seek approach.

Budget committee processes are ultimately uncontrollable by the agency administrator making the budget presentation and a committee member can raise an entirely unpredictable question of fact, one that even the best administrator would not be able to answer without doing considerable background research. In this eventuality, the administrator has a choice: (1) admit that he or she does not know the answer but will provide the answer soon after doing some checking or (2) give a ballpark answer from out of thin air with great confidence and great precision, knowing full well that nobody will be able to verify whether the answer is right or not and that the answer has no real bearing on the operations of the agency. Both approaches are regularly used, but the former is much to be preferred for the sake of good governance. When that approach is taken, the follow-through must be quick and complete.

## The Executive Budget: The Plan and the Balancing

The executive budget document delivers the financial plan for the government, provides a clear statement of the policy vision that shaped those plans, tells the legislature and the public what enactment of the plan would bring, and provides an archive of information about the government and its agencies. It also includes information about operating performance of the government and about the performance plan that is inherent in the financial support that is requested. In all these areas, the message needs to be communicated clearly but concisely; many participants in the process immediately conclude malicious intent for everything that is vague. In other words, the budget should be (1) a policy document, (2) a financial plan, (3) an operations guide, and (4) a device for communicating to the legislature and the public. Many governments post their budget, in detail ranging from summary to complete, on the government's website for easy access by all. Some governments also post the budget requests transmitted by the agency to the central budget office.

The budget, like that delivered to Congress by the president or presented by other executives to their legislative bodies, typically contains four basic elements:

**1. The budget message** is an introduction, from the chief executive, that highlights the major conditions surrounding the budget's preparation (economic conditions, perceived social problems, service priorities, etc.) and the primary changes proposed in the budget. The message sets the tone for the budget ("hard times," "new beginnings and new challenges," "change," "emerging from severe fiscal crisis," "new hope," "new era of responsibility," etc.); in simple budgets, this may be the only narrative in the entire document.[8] The message is where the executive (president, governor, mayor, etc.) makes a statement about which goals matter to him or her. Dall Forsythe sums it up: "If you cannot use the budget to state your goals and move state government in the direction you advocate, you are not likely to make much progress towards those goals."[9]

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[8] For more about the strategy of that message, see Henry W. Maier, *Challenge to the Cities: An Approach to a Theory of Urban Leadership* (New York: Random House, 1966). Maier was the longtime mayor of Milwaukee.

[9] Dall W. Forsythe, *Memos to the Governor, An Introduction to State Budgeting* (Washington, D.C.: Georgetown University Press, 1997), 84–85.